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Nos. 82-34 and 82-226

In the Supreme Court of the United States

OCTOBER TERM, 1982

AMERICAN PAPER INSTITUTE, INC., PETITIONER

v.

AMERICAN ELECTRIC POWER SERVICE CORP., ET AL.

FEDERAL ENERGY REGULATORY COMMISSION, PETITIONER

v.

AMERICAN ELECTRIC POWER SERVICE CORP., ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION

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QUESTIONS PRESENTED

In Section 210(a) of the Public Utility Regulatory Policies Act of 1978 (PURPA), Congress directed the Federal Energy Regulatory Commission to issue rules requiring electric utilities to purchase power from and sell back-up power to qualifying cogeneration and small power production facilities and to establish a rate for such purchases and sales. The questions presented are:

1. Whether the Commission's rule establishing the rate at which utilities must offer to purchase power from qualifying facilities at "full avoided cost" satisfies the statutory directive that the Commission adopt a rule that is just and reasonable to electric consumers, in the public interest, and nondiscriminatory in its effects on qualifying facilities.

2. Whether Section 210(e)(3)(B) of PURPA requires the Commission to conduct an evidentiary adjudication under provisions of the Federal Power Act each time it seeks to compel a utility to interconnect with a qualifying facility for the purpose of effectuating the purchases and sales mandated by the Commission's rules under Section 210(a) of PURPA.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. B-1 to B-34)[1] is reported at 675 F.2d 1226. The opinions accompanying the orders denying rehearing and rehearing en banc (Pet. App. B-202 to B-208) are reported at 675 F.2d 1246. The orders of the Commission (Pet. App.

[1] "Pet. App." refers to the appendix to the petition for a writ of certiorari in No. 82-34.

B-38 to B-119, B-120 to B-174 and B-175 to B-199) are reported at 45 Fed. Reg. 12214, 17959 and 33958, respectively.

JURISDICTION

The judgment of the court of appeals (Pet. App. B-200 to B-201) was entered on January 22, 1982. A petition for rehearing was denied on April 9, 1982 (Pet. App. B-202 to B-208). The petition for a writ of certiorari in No. 82-34 was filed on July 8, 1982. The petition for certiorari in No. 82-226 was filed, pursuant to two extensions of time, on August 9, 1982. The petitions were both granted on October 12, 1982. The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations are set forth in an appendix to this brief.

STATEMENT

A. The Statutory Background

This case involves a judicial challenge to certain regulations promulgated by the Federal Energy Regulatory Commission pursuant to Section 210 of the Public Utility Regulatory Policies Act of 1978 (PURPA), 16 U.S.C. (Supp. V) 824a-3. The constitutional validity of the Act, including Section 210, was upheld by this Court in *FERC* v. *Mississippi*, No. 80-1749 (June 1, 1982). As this Court noted in that case, PURPA was enacted as part of a comprehensive legislative package in an effort to "lessen the country's dependence on foreign oil, to avoid repetition of the shortage of natural gas that had been experienced in 1977, and to control consumer costs." *Id.* at 2.[2]

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[2] Senator Jackson, Chairman of the Senate Energy Committee and one of the principal proponents of the legislation in Congress, stated that PURPA was aimed "at promoting conservation of electric energy by consumers, efficient use of facilities and resources by

1. Section 210 of PURPA was enacted to promote development of cogeneration and small power production facilities[3] based on Congress' judgment that "increased use of these sources of energy would reduce the demand for traditional fossil fuels." *FERC* v. *Mississippi*, *supra*, slip op. 6. In adopting this legislation, Congress recognized that two longstanding problems had frustrated the growth of these alternative sources of electric energy: "(1) traditional electric utilities were reluctant to purchase power from, and to sell power to, the non-traditional [generating] facilities; and (2) the regulation of these alternative energy sources by state and federal utility authorities imposed financial burdens upon the non-traditional facilities and thus discouraged their development." *Id.* at 6-7 (footnotes omitted).

In order to overcome the first problem, Congress, in Section 210(a) of PURPA, 16 U.S.C. (Supp. V) 824a-3(a), directed the Commission, within one year of PURPA's enactment, to prescribe "such rules as it determines necessary to encourage cogeneration and small power production," including rules requiring electric utilities to offer to purchase electricity from, and sell electricity to, qualifying facilities. Section 210(b) of PURPA, 16 U.S.C. (Supp. V) 824a-3(b), provides that

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the utility industry, conservation of capital by more effective use of existing plants and equity in ratemaking." 124 Cong. Rec. 34558 (1978).

[3] The statute defines a "cogeneration facility" as a facility that produces both electric energy and steam or some other form of useful energy, such as heat. 16 U.S.C. (Supp. V) 796(18)(A). A "small power production facility" is a facility that has a production capacity of not more than 80 megawatts and uses biomass, waste, or renewable resources (such as wind, water, or solar energy) to produce electric power. 16 U.S.C. (Supp. V) 796(17)(A).

Unless otherwise specified, "cogeneration" denotes both cogeneration and small power production, and "qualifying facility" designates those cogeneration and small power production facilities authorized by statute to sell electricity to and purchase electricity from utilities.

the Commission's rules requiring the purchase by a utility of electricity from a qualifying facility shall insure that the rates for such purchase are: (1) just and reasonable to the utility's customers and in the public interest; and (2) nondiscriminatory with respect to the qualifying cogeneration or small power production facility. Section 210(b) declares that no rule prescribed by the Commission "shall provide for a rate which exceeds the incremental cost to the electric utility of alternative electric energy."[4] Section 210(f) of PURPA, 16 U.S.C. (Supp. V) 824a-3(f), requires each state regulatory authority and nonregulated utility to implement the Commission's rules.

The second barrier that had hindered the development of these nontraditional energy sources was removed by Section 210(e)(1) of PURPA, 16 U.S.C. (Supp. V) 824a-3(e)(1), which authorizes the Commission to exempt qualifying facilities from federal and state regulation as public utilities if it determines that such exemption is necessary to encourage cogeneration and small power production.

2. In addition to its concern with encouraging cogeneration, Congress also was mindful of the problem of "wasteful over-construction of new generating and transmission facilities * * *."[5] It added Sections 210, 211 and 212 of the Federal Power Act ("FPA" or "Power Act")[6] to meet that problem. These provisions of the Power Act granted the Commission new authority to order, inter

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[4] In Section 210(d), 16 U.S.C. (Supp. V) 824a-3(d), Congress defined the term "incremental cost of alternative electric energy" as "the cost to the electric utility of the electric energy which, but for the purchase from such cogenerator or small power producer, such utility would generate or purchase from another source."

[5] 124 Cong. Rec. 34764 (1978) (remarks of Sen. Metzenbaum).

[6] 16 U.S.C. (Supp. V) 824i, 824j and 824k. These sections were added to the Power Act by Sections 202, 203 and 204 of PURPA.

alia, "any electric utility"[7] to "interconnect" or to "wheel" power[8] if such interconnection or wheeling would "further energy conservation[,] efficient use of facilities or * * * improve reliability."[9] "[A]ny cogeneration facility [or] small power production facility" is also subject to a Commission order to interconnect or otherwise coordinate under Section 210 of the Power Act. Section 210 (e)(3)(B) of PURPA further specifies that the Commission may not exempt qualifying facilities from "the provisions of section 210, 211, or 212 of the Federal Power Act * * *." 16 U.S.C. (Supp. V) 824a-3(e)(3)(B).[10] Before compelling interconnection or wheeling under the Power Act provisions, the Commission must determine that such operations are in the public interest and would conserve energy or capital, optimize efficiency, or improve the reliability of the affected utility systems. See 16 U.S.C. (Supp. V) 824i(c), and 824j(a).

The term "electric utility," as used in FPA Sections 210, 211 and 212, includes entities that previously had been outside the Commission's regulatory control, such as state agencies (16 U.S.C. 824(f)) and utilities that do not sell electricity in interstate commerce (16 U.S.C. 824(e)). See note 7, *supra*. Congress extended the new

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[7] For purposes of Sections 210, 211 and 212 of the Power Act, the term "electric utility" is defined as "any person or State agency which sells electricity." 16 U.S.C. (Supp. V) 796(22).

[8] An "interconnection" is a physical connection that permits electricity to flow from one entity to another (Pet. App. B-20). "Wheeling" has been defined as the "transfer by direct transmission or displacement [of] electric power from one utility to another over the facilities of an intermediate utility." *Otter Tail Power Co.* v. *United States*, 410 U.S. 366, 368 (1973).

[9] 124 Cong. Rec. 34558 (1978) (remarks of Sen. Jackson).

[10] Section 210(e)(3) of PURPA also limits the general exemption authority granted to the Commission in Section 210(e)(1) (see page 4, *supra*) by prohibiting the Commission from exempting qualifying facilities both from state laws implementing the cogeneration rules prescribed by the Commission pursuant to Section 210 of PURPA and from the hydroelectric licensing provisions of Part I of the Federal Power Act.

interconnection and wheeling requirements to these entities in part to eliminate the inefficiencies caused by the refusal of some wholly intrastate utilities to interconnect with interstate systems in order to avoid becoming subject to the full panoply of Federal Power Act regulation.[11] In Section 201(b)(2) of the FPA, Congress specified that while these otherwise nonjurisdictional entities "shall be subject to the jurisdiction of the Commission for purposes of carrying out" orders under the new interconnection and wheeling authority, compliance with such orders would not make such entities subject to the Commission's jurisdiction for any other purposes. 16 U.S.C. (Supp. V) 824(b)(2).

B. The Rules Adopted By The Commission

Following extensive rulemaking proceedings,[12] the Commission issued Order No. 69 (Pet. App. B-38 to B-119), governing transactions between utilities and qualifying facilities. That order embodies a number of regulations designed to accomplish the statutory goal of encouraging the development of cogeneration and small power production. Two of those regulations are at issue here.[13]

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[11] See, e.g., 124 Cong. Rec. 34770 (1978) (remarks of Sen. Bartlett); 123 Cong. Rec. 32397-32398 (1977) (colloquy between Sen. Domenici and Sen. Johnston).

[12] In June, 1979, the Commission issued a staff discussion paper addressing issues arising under Section 210 of PURPA. J.A. 6-35. In addition to receiving written comments on the paper, the Commission's staff held public hearings in San Francisco, Chicago and Washington, D.C. In October 1979, the Commission issued a Notice of Proposed Rulemaking on Section 210 of PURPA. J.A. 36-89. Additional comments were received and public hearings were held in Seattle, New York City, Denver and Washington, D.C. A final draft rule was made available on January 29, 1980, and representatives of electric utilities and public utility commissioners were invited to comment at public meetings held in February, 1980. See Pet. App. B-40 to B-41.

[13] In Order No. 70 (Pet. App. B-120 to B-174), the Commission established criteria for determining when a cogeneration or small power production facility shall be considered a qualifying facility

1. The first regulation provides that the rate for a purchase of electricity by a utility from a new qualifying facility must be equal to the utility's full "avoided costs." 18 C.F.R. 292.304(b)(2). The term "avoided costs" is defined in 18 C.F.R. 292.101(b)(6) as the equivalent of the statutory term "incremental cost of alternative electric energy." See note 4, *supra*.

The Commission noted that "under the full avoided cost standard, the utilities' customers are kept whole, and pay the same rates as they would have paid had the utility not purchased energy and capacity from the qualifying facility" (Pet. App. B-65). In addition, the Commission made the following observations (*ibid.*):

> Although use of the full avoided cost standard will not produce any rate savings to the utility's customers, several commenters stated that these ratepayers and the nation as a whole will benefit from the decreased reliance on scarce fossil fuels, such as oil and gas, and the more efficient use of energy.
>
> The Commission notes that, in most instances, if part of the savings from cogeneration and small power production were allocated among the utilities' ratepayers, any rate reduction will be insignificant for any individual customer. On the other hand, if these savings are allocated to the relatively small class of qualifying cogenerators and small power producers, they may provide a significant incentive for a higher growth rate of these technologies.

The Commission considered, but rejected, a fixed-percentage-of-avoided-cost-rule, finding that such a rule would cause a qualifying facility to cease production of energy if its costs exceeded that fixed percentage price (Pet. App. B-66). The Commission explained that "[i]f this occurs, the utility will be forced to operate generating units which either are less efficient than those which would have been used by the qualifying facility, or which

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within the meaning of PURPA. The regulations adopted in Order No. 70 were upheld by the court of appeals below and are not at issue here.

consume fossil fuel rather than the alternative fuel which would have been consumed by the qualifying facility had the price been set at full avoided costs" (*ibid.*).

2. The second regulation at issue, codified at 18 C.F.R. 292.303, requires electric utilities to: (1) purchase any energy and capacity made available from a qualifying facility; (2) sell energy and capacity to any qualifying facility at the latter's request; and (3) make the interconnections necessary to accomplish such transactions at the qualifying facility's expense.[14] As the Commission recognized, Section 210(a) of PURPA expressly refers only to purchases and sales and not to interconnections. The Commission concluded, however, that Congress' directive that the Commission "prescribe * * * such rules as it determines necessary to encourage cogeneration and small power production" (16 U.S.C. (Supp. V) 824a-3(a)) provides clear authority for the Commission to require the interconnections necessary to accomplish the expressly mandated purchases and sales (Pet. App. B-58 to B-59).

The Commission rejected the argument that under Section 210(e)(3)(B) of PURPA it must afford an evidentiary hearing and "require that qualifying facilities go through the complex procedures [required by Sections 210 and 212 of the Power Act] simply to gain interconnection" for the purpose of effectuating the transactions mandated by Section 210(a) of PURPA (Pet. App. B-59 to B-60). The Commission reasoned that the language of Section 210(a) of PURPA "provides a general mandate for the Commission to prescribe rules necessary to encourage cogeneration and small power production [and thus provides] sufficient authority to require interconnection" (Pet. App. B-60). On the other hand, the Commission determined, to require qualifying facilities to utilize FPA Sections 210 and 212 as the means of obtaining interconnection would "significantly frustrate" achievement of the purpose of Section 210(a) of PURPA, viz., to pro-

[14] The requirement that the qualifying facility bear the expense of making the interconnection is codified at 18 C.F.R. 292.306.

vide a market for the electricity generated by cogenerators and small power producers (Pet. App. B-60).

On rehearing, the Commission adhered to these determinations (Pet. App. B-179 to B-182). It recognized that the "primary question" with regard to the interconnection issue is the proper interpretation of Section 210(e) of PURPA, which empowers the Commission generally to exempt qualifying facilities from regulation as public utilities under the Power Act except—by virtue of subsection (e)(3)(B)—from the authority newly granted in Sections 210 and 212 of the Power Act (Pet. App. B-180). In the Commission's opinion, subsection (e)(3)(B) has no application to Section 210(a) of PURPA, but rather evinces Congress' intent to "impose [certain] obligations on qualifying facilities, including requiring the physical connection of the qualifying facility with the applicant, the sale or exchange [of] electric energy, or an increase in transmission capacity * * *" (Pet. App. B-181). The Commission believed that "[t]o 'exempt' qualifying facilities does not mean to deny them a privilege or right to which they would otherwise be entitled [i.e., to apply for an interconnection order under FPA Section 210]"; rather "it is from these obligations [of FPA Sections 210 and 212 making qualifying facilities subject to an interconnection order] that section 210(e)(3)(B) provides that qualifying facilities may not be exempted" (Pet. App. B-181).

C. The Decision Of The Court Of Appeals

The court of appeals vacated the Commission's rules as to full avoided cost and interconnection (Pet. App. B-1 to B-34).

1. In striking down the "full avoided cost" rule, the court viewed the critical issue as whether the rule "is consistent with the statutory mandate that the rates set by the Commission must, in addition to not discriminating against cogenerators, also be 'just and reasonable to the electric consumer of the electric utility' and 'in the

public interest' " (Pet. App. B-9). The court held that the Commission had not adequately established that the full avoided cost rule met these statutory requirements (*ibid.*).

First, the court determined that the Commission "without convincing explanation had simply adopted as a uniform rule the maximum purchase rate specified in the statute" (Pet. App. B-10). The Commission had failed, in the court's view, to meet the "minimum" requirement that it "make clear and explain how the rates it sets are consistent with the statutory criteria" (*ibid.*). The court believed that the Commission had not "demonstrate[d] the factual basis" for its determination that something less than full avoided cost would result in " 'insignificant' " rate reductions for utility customers (*id.* at B-11). Second, the court upheld the Commission's rejection of a split-the-savings [15] rule on the ground that such a rule "would require utilities-type regulation in contravention of the purpose of PURPA," but the court noted that there are other alternatives that the Commission could have adopted instead of full avoided cost that also might avoid the traditional utilities-style ratemaking that Congress sought to prevent (*ibid.*). Finally, the court asserted that the Commission's determination "that the bare, unquantified possibility that a rule permitting rates at less than full cost *might* be insufficient to encourage the last kilowatt hour of cogeneration" is "inconsistent with the clear intent of section 210(b), which seeks to strike a balance among the interests of cogenerators, 'electric consumers of electric utilit[ies]' and the 'public interest' " (*id.* at B-12; emphasis in original). The court directed that on remand the Commission "should allocate the benefits more evenly between the cogenerators and the utilities if the utilities can demonstrate that, under a percentage of avoided cost

[15] As the court explained, under a "split-the-savings" approach, "the price is set somewhere between the incremental cost of the buying utility and the incremental cost of the selling utility, so that each benefits by the transaction" (Pet. App. B-13 n.37).

approach, an allocation less heavily favoring the cogenerators is in the public interest of the utilities' electric consumers, and will not disproportionately discourage cogeneration" (*ibid.*).

2. The court below also invalidated the rule authorizing interconnections between qualifying facilities and utilities. In its view, since Section 210(e)(3)(B) of PURPA prohibits the Commission from exempting qualifying facilities from Sections 210, 211 and 212 of the Federal Power Act, the Commission must afford evidentiary hearings and make findings under these provisions before ordering any interconnections it deems necessary to accomplish the purchases and sales required under Section 210(a) of PURPA (Pet. App. B-20 to B-25). The court interpreted the Commission's interconnection rule as effectively exempting qualifying facilities from these Power Act procedures, a result that the court believed was inconsistent with the statutory requirements.

The court characterized the Commission's interpretation of Section 210(e)(3)(B) of PURPA "as protecting cogenerators who are *targets* of *other* parties seeking interconnection, and not extended to situations where the cogenerator is an *applicant* for an interconnection itself" (Pet. App. B-24; emphasis in original). While the court agreed that this was "an interesting and not inherently implausible suggestion," it believed that this interpretation was not supported by the language or legislative history of the statute (*id.* at B-25). Finally, the court expressed the view that any undue burden its interpretation placed on qualifying facilities could be avoided by adopting "streamlined procedures," but that, if even those were too burdensome, "the necessary amendment must come from Congress" (*id.* at B-23).

3. The Commission's petition for rehearing was denied by the panel (Pet. App. B-202 to B-204). A majority of the whole court did not participate in considering the suggestion for rehearing en banc and that suggestion also was denied (Pet. App. B-205 to B-208). The only

two judges (apart from the panel members) to consider the suggestion voted to rehear the case en banc "because of the importance of the issues to major new energy programs of cogeneration and small power production and because of serious doubts over the panel's resolution of those issues" (*id.* at B-206).

As to the full avoided cost issue, the dissenters expressed the view that the Commission appears to have acted reasonably in weighing the statutory interests and adopting "a rate that would encourage cogeneration without raising rates to consumers" (Pet. App. B-207), and that the panel erroneously had employed the more stringent "substantial evidence" test rather than the applicable "arbitrary and capricious" standard of review (*id.* at B-207 & n.2).

As to interconnection, the dissenters noted that "[t]he panel has interpreted an incredibly complex and ambiguous interlace of statutory sections to require a full-scale evidentiary hearing prior to any interconnections for the sale or purchase of cogenerated power" (Pet. App. B-207 to B-208). In the dissenters' view, the Commission's interpretation, which the panel rejected, "is a plausible one and appears to be more closely in line with Congress' expressed desire to encourage cogeneration" (*id.* at B-208).

SUMMARY OF ARGUMENT

Pursuant to Section 210(a) of PURPA, the Commission promulgated a series of rules designed to effectuate the congressional directive "to encourage cogeneration and small power production." The court of appeals vacated two of these rules: (1) the rule establishing the rate for purchases of cogeneration-produced power at the utility's full avoided cost; and (2) the rule requiring utilities to interconnect with cogenerators in order to facilitate the purchases of cogeneration-produced power that were mandated by Congress in PURPA Section 210. The court's decision as to both rules is based on a

serious misunderstanding of the statutory and regulatory scheme. Unless overturned, the decision below will substantially thwart the congressional purpose of reducing the nation's reliance on imported oil by encouraging the development of nontraditional energy sources.

I

A. Contrary to the apparent assumption of the court of appeals, Congress clearly contemplated that a full avoided cost rate would be within a "zone of reasonableness," albeit at the upper end of that zone. Although Section 210(b) of PURPA, 16 U.S.C. (Supp. V) 824a-3(b), states that rates for purchases by a utility of cogeneration-produced electricity are to be just and reasonable to the utility's customers and in the public interest, the statute also expressly authorizes the Commission to set rates at a level not to exceed full avoided (or incremental) cost. Thus, a full avoided cost rate is consistent with the literal terms of the statute. Moreover, in holding that the Commission is required under the just and reasonable standard to pass along the benefits of lower costs to the utility's customers, the court below has disregarded the basic statutory mandate, which is to "encourage" cogeneration, not to avoid "disproportionately discourag[ing] cogeneration" (Pet. App. B-12).

B. In addition, the court misapprehended the thrust of the Commission's full avoided cost rule. The rule does not *require* a full avoided cost rate for the purchase of cogeneration-produced power; the rule simply sets the context for bargaining between the utility and the cogenerator. Parties are free to negotiate a contract for purchases at a lower rate. Moreover, the state regulatory commission can seek a waiver of the rule if it shows that a full avoided cost rate is not necessary to encourage cogeneration.

Furthermore, the decision below is grounded on the mistaken premise that the Commission had failed to determine that utilities possess monopsony power. But both Congress and the Commission have stated that a primary

reason for enactment of Section 210 of PURPA was the monopsony power of electric utilities, manifested by their refusal to purchase cogeneration-produced electricity at all, or their unwillingness to pay an appropriate rate for such power.

The court of appeals expressed the belief that rates to consumers would be increased under a full avoided cost standard. This belief is based on an erroneous understanding of the manner in which costs would be allocated to customers under a full avoided cost rule. By definition, full avoided (or incremental) cost is no higher than the cost to the utility of generating electricity itself or purchasing electricity from another source.

C. The court of appeals applied an erroneous standard of review. In vacating the full avoided cost rule, the court appears to have applied the "substantial evidence" test, a standard that not only is incompatible with review of informal agency action generally, but is especially unsuited to reviewing a rule such as the full avoided cost rule, which was adopted as a predictive judgment based on agency expertise regarding the rate level necessary to encourage future cogeneration and small power production. The court's conclusion that it would not uphold the Commission's determination to promulgate the full avoided cost rule unless the rule is supported by specific factual findings represents the same type of judicial interference with agency decisionmaking that this Court condemned in *Vermont Yankee Nuclear Power Corp.* v. *Natural Resources Defense Council, Inc.*, 435 U.S. 519, 547-548 (1978).

II

In empowering the Commission under Sections 210, 211 and 212 of the Federal Power Act to require greater coordination of the nation's electric transmission facilities, Congress dealt with an entirely different problem than the concern addressed in Section 210 of PURPA, which was enacted to remove the impediments to the development of cogeneration and small power production.

The language and history of the Power Act provisions demonstrate that Congress sought to assure that the Commission could require any entity that sells electricity to coordinate its transmission operations with other such entities. Congress hoped that by exercising this power, the Commission could avoid construction by utilities of expensive excess transmission and generating capacity, while at the same time enhancing the reliability of all systems.

On the other hand, in Section 210 of PURPA, Congress sought to remove the barriers that had impeded development of energy-efficient alternative sources of electric power. Thus, Congress required utilities to provide a market for power generated by cogenerators and small power producers and to sell back-up power to them; and Congress provided that these alternative sources of electricity may be exempted from state and federal regulation as public utilities.

At the same time, however, Congress sought to insure that the Commission's broad new Power Act authority to order interconnection would apply to all nonjurisdictional entities, including cogenerators and small power production facilities. Accordingly, in Section 210(e)(3)(B) of PURPA, 16 U.S.C. (Supp. V) 824a-3(e)(3)(B), Congress expressly precluded the Commission from exempting qualifying facilities from that Power Act authority.

Instead of viewing this limitation in light of the distinct congressional purposes underlying the amendments to the Power Act and the provisions of Section 210 of PURPA, the court below erroneously concluded that, under Section 210(e)(3)(B) of PURPA, cogenerators and small power producers must use the Power Act procedures—which require evidentiary hearings and specific public interest findings—each time they wish to interconnect with a reluctant public utility in order to effectuate a purchase and sale mandated under Section 210(a) of PURPA. This interpretation is not only contrary to a common sense reading of the statutory language, but it

also would effectively reimpose the barriers to cogeneration and small power production that Congress sought to remove in enacting Section 210 of PURPA.

ARGUMENT

I. IN VACATING THE COMMISSION'S FULL AVOIDED COST RULE THE COURT OF APPEALS MISCONSTRUED THE UNDERLYING STATUTE, MISPERCEIVED THE NATURE AND EFFECT OF THE RULE, AND APPLIED AN ERRONEOUS STANDARD OF JUDICIAL REVIEW

Throughout its opinion, the court of appeals evinced a strong hostility to the full avoided cost rule adopted by the Commission.[16] This antagonism appears to have influenced the court's ultimate conclusion that the rule did not satisfy the statutory standards. Even more directly, the court's apparent distaste for the rule seems to have triggered its decision to substitute its view of public policy for that of the Commission. The fact is, however, that the court below seriously misunderstood the nature and effect of the rule. Accordingly, as we proceed to identify the court's legal errors we also will document its factual misperceptions in order to demonstrate that the court's misgivings as to a full avoided cost rate are unfounded.

A. The Full Avoided Cost Rule Satisfies The Relevant Statutory Criteria

Following a lengthy rulemaking proceeding conducted pursuant to Section 210 of PURPA, the Commission determined that purchases of electricity by a utility from a new qualifying facility must be at a rate equal to

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[16] E.g., "[T]he Commission came to the simplistic and uniform conclusion that the full avoided cost standard would be just and reasonable in every case and that this was necessary to encourage cogeneration in every case" (Pet. App. B-9); the adoption of the rule "without convincing explanation" avoids "the hard questions * * * *" (*id.* at B-10); the rule is not the product of "reasoned consideration * * * *" (*id.* at B-12).

the utility's full "avoided costs" (18 C.F.R. 292.304 (b)(2)), and it defined "avoided costs" as the equivalent of the statutory term "incremental cost of alternative electric energy." 18 C.F.R. 292.101(b)(6). Although the basis articulated by the court for vacating this rule was that the "[Commission] did not justify and explain its decision to adopt the rule" (Pet. App. B-34), a careful reading of the court's opinion indicates that the court also viewed the full avoided cost rule as inconsistent with the requirements of the statute.[17]

Under the court's analysis (see Pet. App. B-10 to B-12), the rule fails to take account of the "just and reasonable" and "in the public interest" criteria of Section 210(b) of PURPA. This analysis appears to rest on the assumption that under the statutory "just and reasonable" standard, the upper end of the "zone of reasonableness"—the area within which the Commission has the discretion

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[17] Inded, the court stated at one point that the Commission's rejection of a rule that would have established rates at less than 100% of avoided costs "seems entirely inconsistent with the clear intent of section 210(b)" (Pet. App. B-12). Respondents appear to agree with this assessment (see Br. in Opp. 9, 10, 18).

To be sure, in its opinion denying rehearing, the court stated (Pet. App. B-203) that it had not declared the Commission's rule to be inconsistent with the statute. But the court's hostility to the full avoided cost rule appears to rest, at least in part, on the notion that the Commission lacks authority to adopt such a rule, whatever justifying reasons it might proffer.

This Court previously has had occasion to pierce the literal language of a court of appeals' opinion to find the actual basis for the lower court's decision. In *Vermont Yankee Nuclear Power Corp.* v. *Natural Resources Defense Council, Inc.*, 435 U.S. 519, 541-542 (1978), this Court found that, despite the fact that the lower court "refrained from actually ordering the agency to follow any specific procedures, * * * there is little doubt in our minds that the ineluctable mandate of the court's decision is that the procedures afforded during the hearings were inadequate." After concluding that the procedures employed by the agency satisfied legal requirements, this Court reversed the lower court's decision. *Id.* at 542-548.

to select a rate—falls somewhere below the level of full avoided cost. This assumption is based on a statement in the legislative history indicating that the lower of a "just and reasonable" and a full avoided cost rate was to apply.[18] The ultimate logic of this position appears to be that the rates to the electric consumers of a utility can never be considered "just and reasonable" unless such consumers are allowed to share directly in the short term benefits of the new program by virtue of a reduction in their rates. It is our submission that this view misconceives the statutory framework and fails to give adequate consideration to the findings of the Commission.

1. The statute expressly authorizes the Commission to adopt a rule based on full avoided cost. Section 210(b) of PURPA states that "[no] rule [establishing a rate for purchases] shall provide for a rate which exceeds the incremental cost to the electric utility of alternative electric energy." Incremental cost means full avoided cost.[19] At the same time, the Commission is required to establish a rate that is "just and reasonable to the electric consumers of the electric utility and in the public interest * * *." 16 U.S.C. (Supp. V) 824a-3(b)(1).[20] Although Congress did not specifically es-

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[18] See Pet. App. B-9 to B-10, quoting H.R. Conf. Rep. No. 95-1750, 95th Cong., 2d Sess. 98 (1978).

[19] The court of appeals recognized that the full avoided cost standard utilized by the Commission is identical to the statutory concept of "incremental cost * * * of alternative energy." See Pet. App. B-8 n.28.

[20] The terms "in the public interest" and "just and reasonable" are interchangeable terms in the public utility ratemaking context. See, e.g., *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332, 345 (1956); *FPC* v. *Sierra Pacific Power Co.*, 350 U.S. 348, 355 (1956). In both cases this Court concluded that a Commission finding that a rate is so low as to adversely affect the public interest is sufficient to satisfy identical provisions of the Natural Gas Act and the Federal Power Act requiring a Commission finding that a rate is "unjust" or "unreasonable" before the

tablish a "zone of reasonableness" for the Commission in mandating a just and reasonable rate for purchases, it expressly declared, in Section 210(b) of PURPA, that the rate may not exceed incremental (or full avoided) cost. Thus, Congress clearly contemplated that a full avoided cost rate would be within that zone, albeit at the upper end. See H.R. Conf. Rep. No. 95-1750, 95th Cong., 2d Sess. 98 (1978).

It is settled that "courts are without authority to set aside any rate selected by the Commission which is within a 'zone of reasonableness.'" *Permian Basin Area Rate Cases*, 390 U.S. 747, 767 (1968), quoting *FPC* v. *Natural Gas Pipeline Co.*, 315 U.S. 575, 585 (1942). Indeed, it is firm doctrine that the "Commission may, within this zone, employ price functionally in order to achieve relevant regulatory purposes; it may, in particular, take fully into account the probable consequences of a given price level for future programs of exploration and production." *Mobil Oil Corp.* v. *FPC*, 417 U.S. 283, 317 (1974), quoting *Permian Basin*, *supra*, 390 U.S. at 796-798. The Commission's full avoided cost rule, by not exceeding the upper limit set by Congress, clearly falls within the zone of reasonableness. Thus, the court of appeals erred in setting the rule aside on the belief that Congress required the Commission to set the rate for purchases at a level below incremental cost.

2. The court's erroneous view of the statutory standard is underscored by its misapprehension of the showing that would be necessary to support adoption of a full avoided cost rule. In the court's opinion, the statute requires an immediate "share of the benefits" to the utilities' customers so long as that would not "*disproportionately dis-*

Commission may fix a new rate. By the same token, the terms "public interest" and "just and reasonable to the electric consumers" in Section 210(b)(1) of PURPA surely enlarge the Commission's regulatory focus beyond the narrow question whether a particular rate for purchases of electricity from qualifying facilities will actually result in lower rates to consumers.

courage cogeneration" (Pet. App. B-12; emphasis added). That, however, is not the statutory standard. As the Commission recognized, the central aim of Congress in Section 210 of PURPA was to *encourage* cogeneration through a program that serves the interest of the public and of the utilities' customers.

While the Commission recognized that "the full avoided cost standard will not produce any rate savings to the utility's customers" (Pet. App. B-65), it did not view this as the dispositive consideration. On the contrary, the Commission concluded that "these ratepayers and the nation as a whole will benefit from the decreased reliance on scarce fossil fuels, such as oil and gas, and the more efficient use of energy" (*ibid.*).[21] Under this approach, the utilities' customers are "kept whole" while "a significant incentive [is provided] for a higher growth rate of [cogeneration and small power production] technologies" (*ibid.*).

3. The court of appeals' rejection of the Commission's considered interpretation of the statute represents a marked departure from traditional standards governing judicial review of an agency's construction of the statute it administers. As this Court has made clear, "in determining whether the Commission's action was 'contrary to law,' the task for the Court of Appeals was not to interpret the statute as it thought best but rather the narrower inquiry into whether the Commission's construction was 'sufficiently reasonable' to be accepted by a reviewing court." *FEC* v. *Democratic Senatorial Campaign Committee*, 454 U.S. 27, 39 (1981). Respect for the agency's view is particularly appropriate "when the administrative practice at stake involves a contemporaneous construction of a statute by the men charged with the responsibility of setting its machinery in motion,

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[21] As we have observed (see note 20, *supra*), the inquiry under the statute does not focus on the consumers' interests in isolation, but rather examines their concerns in the context of the broader "public interest."

of making the parts work efficiently and smoothly while they are yet untried and new." *Udall* v. *Tallman*, 380 U.S. 1, 16 (1965), quoting *Power Reactor Development Co.* v. *International Union of Electrical, Radio & Machine Workers*, 367 U.S. 396, 408 (1961). See *Zenith Radio Corp.* v. *United States*, 437 U.S. 443, 450 (1978). The court below failed to follow these precepts in this case. Moreover, as we now show, the court compounded this error by substituting its judgment for that of the Commission, contrary to the well established principle that courts " 'should not overrule an administrative decision merely because they disagree with its wisdom.' " *CBS, Inc.* v. *FCC*, 453 U.S. 367, 394 (1981), quoting *Radio Corp. of America* v. *United States*, 341 U.S. 412, 420 (1951).

B. The Court Of Appeals' Detailed (And Erroneous) Evaluation Of The Full Avoided Cost Rule Reflects Its Improper Intrusion Into The Domain Reserved To The Administrative Agency

We have already suggested that the court of appeals' erroneous view of the statute was bottomed in large part upon its failure to understand the Commission's full avoided cost rule. Even more seriously, the court's misapprehension of, and manifest hostility to, the rule colored the scope of its review of the Commission's decision. After first focusing on the court's errors with regard to the nature and effect of the full avoided cost rule, we will demonstrate that the court erred in substituting its own views for those of the Commission and in applying an erroneous standard of review.

1. *The Full Avoided Cost Rule does not automatically require that the actual rate paid by a utility to a qualifying facility be fixed at full avoided cost*

The court below incorrectly assumed that utilities would always have to pay a full avoided cost rate to qualifying facilities. Thus, the court stated, "[b]ut for

FERC's regulations, the utility may have paid a cogenerator a market purchase rate of something less than the full avoided cost, under a standard industry practice" (Pet. App. B-13; footnote omitted). Elsewhere the court remarked that "the Commission came to the simplistic and uniform conclusion that the full avoided cost standard would be just and reasonable in every case and that this was necessary to encourage cogeneration in every case" (*id.* at B-9). The court's assumption is entirely unfounded.

To begin with, although Section 210(f) of PURPA requires the states to "implement" the Commission's rules, any state regulatory authority and any nonregulated electric utility may apply to the Commission for a waiver of its rules. Waivers may be granted where a full avoided cost rate is demonstrated to be unnecessary to encourage cogeneration or small power production. See 18 C.F.R. 292.403.[22]

Even more important, however, under the Commission's rules, qualifying facilities and utilities may negotiate contract prices that are lower than a full avoided cost rate. See 18 C.F.R. 292.301(b)(1). Both the utility and the qualifying facility obtain significant advantages from such a negotiated agreement. Many qualifying facilities must secure a long term agreement with a utility in order to obtain institutional financing for a project. Because the Commission's rules do not require a utility to sign a long term contract with a qualifying facility, the utility is in a position to negotiate a price below full avoided cost in return for a long term com-

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[22] Moreover, state regulators and nonregulated utilities are permitted, without seeking a waiver, to set the rate at a level below full avoided cost for purchases from facilities whose construction began prior to the effective date of PURPA if they determine that a lower rate is consistent with the statutory standards and is sufficient to encourage cogeneration and small power production. See 18 C.F.R. 292.304(b)(3).

mitment. In this way the qualifying facility, the utility and the utility's customers all benefit.[23]

Thus, the fundamental error of the court of appeals was its failure to recognize that the very purpose and intended effect of the full avoided cost rule is to avoid the fixing of an unalterable economic relationship. Instead, as the Commission pointed out (Pet. App. B-49), the aim of the rule is to set the context for bargaining between qualifying facilities and utilities. Only in the event that a qualifying facility and a utility fail to reach agreement would the state regulatory authority be required to apply the full avoided cost rule. As this Court recognized in *FERC* v. *Mississippi*, *supra*, slip op. 16, "the statute and the implementing regulations simply require the [state] authorities to adjudicate disputes arising under the statute." See also *id.* at 1-2 n.1 (O'Connor, J., concurring in part in the judgment and dissenting in part). Moreover, as noted above, even where the seller and the purchaser are unable to agree on a rate, the state would be free to petition the Commission for a waiver of the full avoided cost rule.

In enacting Section 210 of PURPA, Congress recognized that increased electric energy production by efficient qualifying facilities will replace more expensive and less efficient generation by utilities and help to avoid or defer construction of generating capacity. See *FERC* v. *Mississippi*, *supra*, slip op. 6, 13. Ultimately, this will reduce utility rates and directly benefit consumers and the nation.[24] Furthermore, in promulgating the full avoided cost rate, the Commission reasoned (Pet. App.

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[23] As the Commission explained (Pet. App. B-49), its rules also provide that contracts already in existence prior to the issuance of the rules will not be disturbed, even if they provide for a rate below full avoided cost. See 18 C.F.R. 292.301(b)(2).

[24] See, e.g., L. Johnson & D. Seidman, The Rand Corporation, No. N-1876-DOE, *An Analysis of the Department of Energy's Nonprice Regulation of Industrial Energy Use* 27-39 (May 1, 1982).

B-65 to B-66) that a lower rate undoubtedly would deter some cogeneration and small power production and thus perpetuate the inefficiencies of traditional power production, to the ultimate detriment of the consumer.

In the end, a rate set at full avoided cost simply duplicates the context that would exist in a competitive and unregulated market.[25] Although the court of appeals expressed a strong preference for regulation of prices by the market without governmental interference (Pet. App. B-14 to B-16), the court acknowledged that its discussion regarding marketplace regulation rested on the assumption that utilities "are subject to some competitive restraints" (*id.* at B-16). As we now show, that assumption too was totally unwarranted.

2. *The court of appeals ignored the findings of Congress and the Commission that utilities possess monopsony power*

The court of appeals was of the view that the statutory "command that the interests of consumers and the public be taken into account contemplates consideration of the degree to which market forces may encourage utilities to purchase, and cogenerators to sell, a substantial amount of cogenerated power at a price lower than the statutory limit" (Pet. App. B-14; emphasis omitted). Accordingly, the court's opinion contains a lengthy discussion of the theoretical price of cogenerated power in a competitive market (*id.* at B-14 to B-16). The court explained (*id.* at B-16) that this discussion was relevant because the Commission had failed to determine that utilities possess monopsony power.[26] The court suggested

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[25] In a perfectly competitive market, price is set at or near the level of marginal cost. See 1 A. Kahn, *The Economics of Regulation* 65-67 (1970). Full avoided cost, or incremental cost, approximates marginal cost.

[26] Monopsony power is like monopoly power except that it applies to purchasers in the market rather than to sellers. See *Permian Basin Area Rate Cases*, 390 U.S. 747, 794 n.64 (1968); *Pan-Islamic Trade Corp.* v. *Exxon Corp.*, 632 F.2d 539, 548 n.13 (5th Cir. 1980),

that if the Commission had made such a finding, "then the Commission may have been justified in its present regulation of rates charged by the utilities" (*ibid.*). The fact of the matter is, however, that both Congress and the Commission did make that very finding.

Indeed, while it did not use that precise term, the court of appeals itself acknowledged (Pet. App. B-4) that the monopsony power of electric utilities was a primary reason for enactment of Section 210 of PURPA. Thus, in explaining the "major obstacles" faced by a cogenerator or small power producer prior to PURPA, the court observed that "utilities were often unwilling to purchase the other producers' electric output at all or were unwilling to pay an appropriate rate" (Pet. App. B-4).[27] Similarly, in *FERC* v. *Mississippi*, *supra*, slip op. 6, this Court stated that it was Congress' belief that the development of nontraditional generating facilities (i.e., cogeneration and small power production facilities) was impeded by, inter alia, the reluctance of traditional electric utilities to purchase power from the nontraditional sources.[28]

The court of appeals recognized that Congress designed Section 210 of PURPA "to remove [this] institutional barrier[] to the development of small power production and cogeneration" (Pet. App. B-5). But the court lost sight of the fact that it is precisely the utility's economic ability successfully to refuse to purchase a qualifying facility's output or to pay "an appropriate rate" (*id.* at B-4) that demonstrates its monopsony power.

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cert. denied, 454 U.S. 927 (1981). This market power is generally demonstrated by an ability to control prices and output, or to exclude competitors. See *American Tobacco Co.* v. *United States*, 328 U.S. 781, 811 (1946); *In Re Beef Industry Antitrust Litigation*, 600 F.2d 1148, 1154 n.3 (5th Cir. 1979), cert. denied, 449 U.S. 905 (1980).

[27] The Commission made a similar observation in its order adopting the full avoided cost rule (Pet. App. B-39).

[28] Both this Court, in *FERC* v. *Mississippi*, *supra*, slip op. 6-7 n.12, and the court of appeals in this case (Pet. App. B-4 n.8) cited the legislative history of PURPA in support of this point.

In this context, the court's discussion of the role of free market forces on the price of electricity produced by means of cogeneration is entirely beside the point. For example, the court asserted (Pet. App. B-15 to B-16; emphasis added):

> Cogenerators are in the same position as coal or oil producers—if they are offered a sufficient price by the public utilities and are relieved from burdensome utility-type regulation, they will produce the needed power and sell it to the public utilities. *One reason that these sources have not done so before is that they feared regulation as public utilities.* The law which Congress passed was intended to correct the market distortions caused by government regulations and by the utilities—not to create new ones.

In this discussion, the court failed to focus on the second major reason why cogenerators had not entered the market successfully prior to PURPA—i.e., the refusal of utilities to purchase cogenerated power altogether or the utilities' practice of agreeing to purchase such power only at a very low price, thus preventing cogenerators from competing in the marketplace.[29]

Even assuming the existence of a competitive market for cogeneration-produced power, Congress, in Section 210(a) of PURPA, nonetheless expressly directed the Commission to issue rules "as it determines necessary to encourage cogeneration and small power production." This statutory directive rests in large part on the determination by Congress that "the development of cogeneration and small power production facilities would conserve energy." *FERC* v. *Mississippi*, *supra*, slip op. 13. In light of this congressional finding, it is readily apparent that Congress desired to promote these alternative sources of energy for the reason that their development

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[29] Moreover, the court's statement comparing cogenerators to coal and oil producers is wide of the mark. Unlike cogenerators, coal and oil producers are not constrained to sell their product to a single customer.

would benefit the nation as a whole—including, as the Commission found (Pet. App. B-65), the customers of electric utilities. On the other hand, leaving the price of cogenerated power to the vicissitudes of the current market for electric power, as the court seems to suggest, would contradict Congress' express intent.

3. *The Full Avoided Cost Rule will not result in higher rates to utility customers*

The court of appeals expressed a concern that a full avoided cost rate for cogeneration-produced electricity could result in higher electric rates for the customers of the utility (Pet. App. B-13).[30] This is also incorrect. A qualifying facility selling power to a utility does not "reduce the number of customer-purchased kilowatt hours over which the utility can spread a share of the fixed costs" of extra capacity (*ibid.*), as the court below thought. Such a sale simply replaces capacity and/or energy; it does not affect customer load on the utility's system.

An industrial concern that in the past has purchased power from a utility will continue such purchases even though, as a qualifying facility, it will also be selling power to the utility. Under the simultaneous purchase and sale rule affirmed by the court below (Pet. App. B-16 to B-20), a qualifying facility may sell all of its power at a full avoided cost rate (or at some other rate determined by negotiation) and purchase the power it needs at the utility's retail rate. Under this scheme, a qualifying facility will sell all of the power it produces if the avoided cost rate is higher than the retail rate. Because the qualifying facility in this situation will purchase the same amount of power that it did before, the utility will

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[30] The court's apparent concern is that the production of electricity through cogeneration may reduce customer load on the utility's system. Since the utility's costs will be the same under a full avoided cost rate for purchases from a cogenerator, the utility's customers, according to the court, will end up paying higher rates because the utility's costs will be spread over fewer billing units.

spread its costs to customers over the same number of kilowatt hours and therefore the customer rates will remain the same.

On the other hand, if the utility's retail rate is higher than the full avoided cost rate, the qualifying facility will consume rather than sell the power it produces to avoid paying the higher retail rate. This will reduce the total number of kilowatt hours on a utility's system. But this result cannot be attributed to a full avoided cost for utility purchases. In fact, this result can only occur if the avoided cost rate is too *low*.

As the dissenters from the denial of rehearing en banc pointed out, the Commission selected a rate "that it believed would provide the greatest incentives for cogeneration, as well as the greatest incentives to decrease our national reliance on fossil fuels, *without leading to any increase in rates paid by electric consumers*" (Pet. App. B-206; emphasis added). This conclusion is inescapable, since the Commission's rule sets the rate at full avoided (or incremental) cost which, by definition, is "the cost to the electric utility of the electric energy which, but for the purchase from such cogenerator or small power producer, such utility would generate or purchase from another source." 16 U.S.C. (Supp. V) 824a-3(d).[31]

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[31] The court's other assumptions as to the effect of the full avoided cost rule are also flawed. The court suggested that the Commission in promulgating the rule failed to accommodate the public interest by not considering possible higher pollution effects and lower tax recovery effects from the encouragement of cogeneration (Pet. App. B-12 to B-13).

But the Commission's environmental assessment (45 Fed. Reg. 23661, 23682-23683 (1980)) indicated generally that there would be no significant environmental impacts associated with the development of any PURPA-induced technology at full avoided cost. Moreover, the Commission specifically concluded that employment of these technologies would result in significant net reductions in the use of oil, natural gas and coal. *Id.* at 23683. The single exception involves the Commission's ongoing consideration of the effects of diesel-fueled cogeneration in New York City, on rehear-

C. In Vacating The Full Avoided Cost Rule The Court Of Appeals Applied An Erroneous Standard Of Review

1. This Court has repeatedly stated that rules promulgated after informal rulemaking are subject, not to the "substantial evidence" test, but to an "arbitrary and capricious" standard. See, e.g., *FCC* v. *WNCN Listeners Guild*, 450 U.S. 582, 594 (1981); *FCC* v. *National Citizens Committee for Broadcasting*, 436 U.S. 775, 803 (1978). Yet, in vacating the full avoided cost rule, the court below appears instead to have relied on the rule of *Public Systems* v. *FERC*, 606 F.2d 973 (D.C. Cir. 1979), a case in which the court had applied a "substantial evidence" test on review of an informal rulemaking by the Commission under the Federal Power Act. It is true

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ing of its order qualifying such facilities. Order No. 70-E, 46 Fed. Reg. 33025 (1981).

The court's reference to taxes (Pet. App. B-12) is puzzling. There should be no difference in income tax revenue recovery as a result of the full avoided cost rule, since the utility will continue to supply service to its customers at the same rates as before; the only difference will be that cogenerated power will replace utility-generated power. If the court's reference is to tax benefits made available to qualifying facilities under the Energy Tax Act of 1978, Pub. L. No. 95-618, 92 Stat. 3174 *et seq.*, its argument is wide of the mark. The statutory requirement that the Commission issue rules to encourage technologies that are energy efficient and not dependent on fossil fuels is consistent with Congress' establishment of tax benefits for such enterprises. Congress has determined that the promotion of alternative energy is of greater public benefit than additional tax dollars to the Treasury from traditional energy sources. See Montgomerie, *Federal Income Tax Incentives for the Development and Use of Alternative Energy Sources*, 14 Nat. Resources Law. 339 (1981). The full avoided cost rule merely provides the maximum encouragement contemplated by Congress. Moreover, any tax statute that provides greater benefits for cogenerators than for utilities can be revised at the discretion of the taxing body if that body finds that it would be appropriate to recover greater tax revenues from cogenerators. This would apply to state and local taxes as well as to federal taxes.

that the provision of the Power Act governing judicial review (16 U.S.C. 825*l*(b)) "prescribes a 'substantial evidence' standard for findings of fact in orders." *Public Systems* v. *FERC*, *supra*, 606 F.2d at 979. But, as the dissenters from the denial of rehearing en banc recognized (Pet. App. B-207 n.2), because Section 210 of PURPA—pursuant to which the full avoided cost rule was promulgated—did not amend the Federal Power Act, there was no basis for employing the "substantial evidence" standard of review rather than the more lenient "arbitrary and capricious" standard required by the Administrative Procedure Act, 5 U.S.C. 706(2)(A).[32]

2. Based on its application of the erroneous substantial evidence test, the court of appeals deemed it "especially necessary" that the Commission on remand "demonstrate the factual basis for its conclusion of 'insignificant' savings for [consumers]'" (Pet. App. B-11). But the court did not indicate how the Commission could better support in a rulemaking record any particular percentage of avoided cost other than 100%, or full avoided cost.[33] Presumably, if the Commission instead

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[32] Indeed, it may also be argued that the "substantial evidence" test is not applicable to review of an informal rulemaking proceeding under the Federal Power Act and that, therefore, *Public Systems* was erroneously decided.

[33] The difficulties involved in establishing any particular percentage figure are formidable. The necessary analysis would require consideration of the cost of electric energy and capacity from every sort of cogeneration and small power production technology. These technologies may include steam turbines, combustion turbines, internal combustion engines, solar cells, windmills, and hydro turbines. The fuels used may range from biomass, waste, and geothermal energy in the case of small power production facilities to coal, oil, gas, and nuclear energy for cogenerators. Furthermore, the Commission has received notice of qualifying status for facilities of widely varying capacities, ranging from a single kilowatt to 600 megawatts—a six hundred thousand-fold difference. Even if all production costs could be estimated, the Commission would still have to determine whether a particular rate would be sufficient to

had selected 75% or 85% of avoided cost, it still would be subject to the identical claim that its decision was not factually supported.

The truth is that none of those who filed comments in the rulemaking proceeding made any effort to demonstrate that any particular percentage figure would be sufficient to induce the development of cogeneration and small power production. It apparently was understood by all that the full avoided cost rule was adopted as a predictive judgment based on agency expertise regarding the rate level necessary to encourage future cogeneration and small power production, and that factual justification was neither possible nor required. See, e.g., *FCC* v. *WNCN Listeners Guild, supra*, 450 U.S. at 594-595; *FPC* v. *Transcontinental Gas Pipe Line Co.*, 365 U.S. 1, 28-29 (1961). There is no reason to believe—and, indeed, it is highly unlikely—that a subsequent rulemaking would produce a better record in this regard.[34]

At bottom, the decision below represents the same type of judicial interference with agency rulemaking procedures that this Court condemned in *Vermont Yankee Nuclear Power Corp.* v. *Natural Resources Defense*

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encourage developers whose required rates of return may be markedly different. Cogenerators may be major corporations (engaged in many diverse industrial activities), limited partnerships, owners of commercial properties, non-profit entities such as schools or hospitals, and private individuals. See Br. of Diamond Shamrock, et al., as amici curiae, for a description of various technologies, fuel sources and developers involved in the cogeneration program.

[34] It also should be noted that Congress directed the Commission to promulgate its rules under Section 210 of PURPA within a one-year deadline. As the District of Columbia Circuit itself has recognized, "unless we are quite certain of our basis for doing so, we must be slow to overturn the Agency's judgment, whichever way it may incline, when Congress has required it to act quickly and decisively despite the lack of exact data." *Weyerhaeuser Co.* v. *Costle*, 590 F.2d 1011, 1026 (1978).

Council, Inc., supra, 435 U.S. at 547-548: "If the agency is compelled to support the rule which it ultimately adopts with the type of record produced only after a full adjudicatory hearing, it simply will have no choice but to conduct a full adjudicatory hearing prior to promulgating every rule."

3. Indeed, by directing the Commission on remand to consider a host of "concerns" raised by the full avoided cost rule (Pet. App. B-12 to B-16), the court below has, in essence, substituted its judgment for that of the Commission. For example, the court stated that the Commission "*should allocate the benefits more evenly* between the cogenerators and the utilities if the utilities can demonstrate that, under a percentage of avoided cost approach, an allocation less heavily favoring the cogenerators is in the public interest and the interest of the utilities' electric consumers, and *will not disproportionately discourage* cogeneration" (*id.* at B-12; emphasis added). But Congress left it to the Commission, not the courts, to balance these interests. See, e.g., *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 577 (1981); *Citizens to Preserve Overton Park, Inc.* v. *Volpe*, 401 U.S. 402, 416 (1971).[35] As the Commission demonstrated (see pages 7-8, *supra*), the full avoided cost rule is the result of a reasonable balancing of these interests. While the court might have preferred a different rule as a matter of policy, the court exceeded its authority by overruling the Commission's judgment on that ground.[36]

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[35] Moreover, as we have already pointed out (see pages 19-20, *supra*), this judicial directive ignores the fact that in Section 210(a) of PURPA, Congress expressly authorized the Commission to issue rules that will "encourage cogeneration," not rules that "will not disproportionately discourage cogeneration."

[36] The court faulted the Commission for failing to consider a flexible rule setting the rate within a range of 80-100% of avoided cost (Pet. App. B-12; see also *id.* at B-203). The court acknowl-

D. The Court Of Appeals' Erroneous Decision To Vacate The Full Avoided Cost Rule Jeopardizes A Significant Federal Program For The Development Of New And Efficient Energy Sources That Is Still In Its Infancy

Unless the decision below is overturned, the substantial benefits that Congress sought to achieve in enacting Section 210 of PURPA—i.e., increasing the efficient use of energy and reducing the nation's reliance on traditional fossil fuels—may never be realized. A majority of the states have complied with the requirements of Section 210 of PURPA by implementing the Commission's full avoided cost rule.[37] If the lower court's decision is

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edged that Congress intended cogenerators to be regulated in a less burdensome manner than traditional utilities (*id.* at B-10), but failed to explain how an 80-100% of avoided cost rule might accomplish this result. In fact, this sort of rule would simply shift the regulatory burden to the states to determine precisely where within the range the rate should be set in any given case. Presumably, each cogenerator would have to develop a utility-type cost of service to determine if a rate exceeding 80% of full avoided cost would be needed to encourage it to produce electricity through cogeneration. This is exactly the sort of utility regulation that Congress sought to avoid. The court itself admitted that "it would probably be an untoward burden and expense to determine permissible rates on a case-by-case basis, or perhaps even a cogeneration method-by-cogeneration method basis. Such a requirement would, in fact, be inconsistent with the overarching congressional intent to streamline rather than impede the implementation of cogeneration" (*id.* at B-16). Yet the court's suggestion of a percentage range rule not only thwarts the intent of Congress, but attempts to impose a policy judgment entrusted by Congress to the Commission. Thus, the court stated at one point (*id.* at B-7 n.26) that "[i]f [respondents] prevail before this Court, the rule will be changed to permit the states to allow the [respondents] to purchase electricity at prices lower than those now required."

[37] Based on information provided to the Commission by the states pursuant to 18 C.F.R. 292.401(c), 39 state commissions have implemented the full avoided cost rule.

permitted to stand, however, the validity of the states' implementing regulations may be jeopardized.

Furthermore, the several years' delay that would result from the initiation of a new rulemaking in a remanded proceeding may cause potential industrial cogenerators to forego the option of building new cogeneration facilities due to the uncertainty of the price that those firms can obtain from sales of cogenerated power. In addition, sources of funds for project financing of qualifying facilities are likely to diminish since the revenue stream from the output of a qualifying facility would no longer be assured. It is also safe to say, if past experience is a reliable guide, that utilities will be unwilling to negotiate contracts with qualifying facilities, or will only offer an unreasonably low price for cogenerated power once the full avoided cost rule—the context for bargaining—is removed.

Finally, we note that Section 210 of PURPA contemplates periodic revisions to the rules concerning cogeneration and small power production. Thus, Section 210(a) states that within one year of PURPA's enactment, "the Commission shall prescribe, *and from time to time thereafter revise*, such rules as it determines necessary to encourage cogeneration and small power production * * *." 16 U.S.C. (Supp. V) 824a-3(a) (emphasis added). After the Section 210 program and the now emergent alternative energy industry are more firmly established, the Commission will have an opportunity to reexamine its full avoided cost rule. With the benefit of experience gained from actual implementation of the full avoided cost rule, the Commission may later find that such a rule is no longer necessary to encourage cogeneration and small power production. The effect of the decision below, however, is to thwart the program at its very inception.

II. THE COMMISSION HAS COMPLETE AUTHORITY UNDER SECTION 210(a) OF PURPA TO REQUIRE UTILITIES TO INTERCONNECT WITH QUALIFYING FACILITIES AS A NECESSARY INCIDENT OF ITS SPECIFIC STATUTORY DUTY TO ENCOURAGE COGENERATION BY THE ADOPTION OF RULES FOR THE PURCHASE AND SALE OF ELECTRIC POWER BETWEEN UTILITIES AND QUALIFYING FACILITIES

The central purpose of Section 210 of PURPA is to encourage production of electricity by qualifying cogeneration and small power production facilities. To that end, Congress, in Section 210(a) of PURPA, directed the Commission to issue rules requiring electric utilities to purchase power from these nontraditional facilities and to provide them back-up power at nondiscriminatory rates. The Commission interpreted Section 210(a) as granting it power to issue a generic rule requiring interconnection in order to implement the statutory mandate of encouraging cogeneration and small power production. The court of appeals' decision vacating the Commission's interconnection rule, like its decision vacating the full avoided cost rule, is based on a serious misperception of the statutory scheme.

Despite the plain fact that interconnection is an integral, indeed essential, condition to the achievement of cogeneration under Section 210(a) of PURPA, the court of appeals nevertheless held that whenever a qualifying facility seeks to interconnect with an unwilling utility in order to engage in cogeneration, it will be required to undergo an evidentiary adjudication to determine if the interconnection is justified under Sections 210 and 212 of the Federal Power Act, 16 U.S.C. (Supp. V) 824i and 824k. The court's conclusion essentially rests on its interpretation of Section 210(e)(3)(B) of PURPA, 16 U.S.C. (Supp. V) 824a-3(e)(3)(B), which provides, inter alia, that the Commission may not exempt qualifying facilities from the Commission's newly granted authority under

Section 210 of the Power Act to compel any cogenerator or small power producer (whether a qualifying facility or not), or any other entity that sells electricity, to interconnect with any electric utility or qualifying facility. As the court viewed it (Pet. App. B-22; emphasis in original):

> By requiring "*any*" utility to make interconnections with "*any*" cogenerator FERC designates, the Commission would in effect exempt qualifying cogenerators from the other procedural and substantive requirements * * * in FPA sections 210 and 212, and deprive utilities of the safeguards afforded by those provisions.

It is our submission that this analysis is seriously flawed because it is based on a misreading of Section 210(e)(3)(B) of PURPA and it puts the statute at cross purposes.

There is no question that in Section 210 of PURPA, Congress enacted legislation to promote cogeneration and small power production. On the other hand, Sections 210, 211 and 212 of the Power Act were enacted to achieve greater coordination and reliability among the nation's electric transmission systems. These different statutory goals address two entirely discrete aspects of efficient use of facilities and resources, and Congress dealt with them separately. The court of appeals' failure to appreciate the distinct purposes of these separate statutes led it to err by superimposing the requirements of the new Power Act provisions onto Section 210 of PURPA.

A. The Power Act Amendments Were Intended To Enhance The Efficiency And Reliability Of Transmission Systems Nationwide; They Have Nothing To Do With PURPA's Separate Goal Of Encouraging Cogeneration

1. Prior to the enactment in 1978 of Section 210 of the Federal Power Act, the Commission's authority to order

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interconnections was limited, under Section 202(b) of that Act, 16 U.S.C. 824a(b), to utilities over which it had regulatory jurisdiction and, except for emergencies, to situations in which a "person engaged in the * * * sale of electric energy" had applied for an order directing a jurisdictional utility to interconnect. The legislative background of FPA Section 210 shows that some intrastate utilities had in the past refused to make interconnections with other systems because, had they done so, they would have become part of an interstate system and thereby subject to the full range of federal regulation under the Federal Power Act. The Commission, under its then-existing authority, was powerless to remedy this problem.

Congress enacted Sections 210, 211 and 212 of the Power Act to grant remedial authority to the Commission to cope with these transmission problems and thereby enhance the reliability of all electric power systems. The new Power Act provisions are thus aimed at improving the coordination of electric transmission operations in order to optimize economic use of the nation's generating capacity while at the same time enhancing reliability. And it is from the requirements that Congress found necessary to achieve these aims—which are entirely distinct from the purchases and sales necessary to promote cogeneration—that the Commission may not exempt qualifying facilities under Section 210(e)(3)(B) of PURPA.

2. This separate statutory goal is plain from the face of the Power Act provisions themselves. Section 210(a)(1) of the Power Act, 16 U.S.C. (Supp. V) 824i(a)(1), empowers the Commission, "[u]pon application of any electric utility, Federal power marketing agency, * * * qualifying cogenerator or qualifying small power producer," to issue an order requiring "the physical connection of any cogeneration facility, any small power production facility, or the transmission facilities of any

electric utility, with the facilities of such applicant." [38] Thus, in Section 210 of the Power Act, Congress was broadly concerned with ensuring the availability of interconnections necessary to coordinate transmission of electricity throughout the nation, not with controlling exchanges of power at the distribution level for cogeneration purposes.[39]

Sections 210(b) and (c) of the Power Act further confirm that the Power Act amendments are wholly unrelated to cogeneration. Those provisions require the Commission, upon receipt of an application for an interconnection order, to issue a notice, to "afford an opportunity for an evidentiary hearing," and, before ordering an interconnection, to make a determination that the interconnection is in the public interest and would conserve energy or capital, optimize efficiency, or improve the re-

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[38] In addition to authorizing the Commission to order interconnections, Congress in FPA Section 210 also empowered the Commission to order "sales" and "exchanges" of electricity. The congressional mandate to the Commission in Section 210(a) of PURPA to require utilities to engage in sales of back-up power to cogenerators would thus be redundant unless Congress, in FPA Section 210, had in mind sales other than those required under PURPA.

[39] Permitting qualifying facilities to apply for such interconnection orders is entirely consistent with Congress' concern with optimizing use of the nation's electric transmission systems. For instance, it is quite conceivable that a qualifying facility might seek to use another cogenerator's or small power producer's lines, rather than build its own lines, to transmit power to a more distant utility. Or a qualifying facility selling electric power at the retail level under the regulation of state authorities might wish to interconnect with a utility or another small power producer to assure an additional supply of power that it could draw upon to serve its customers. In the 1978 amendments to the Power Act, Congress clearly wished to empower the Commission, in these and similar circumstances, to order interconnections that would optimize efficient use of existing facilities.

liability of the affected utility systems. See 16 U.S.C. (Supp. V) 824i(b) and (c).[40] Congress could not possibly have meant for the Commission to make these findings every time a qualifying facility seeks to interconnect with a utility for the purpose of effectuating the purchases and sales mandated by Section 210(a) of PURPA, because in enacting the latter statute Congress itself struck the balance in favor of compelling utilities to purchase electricity from any qualifying facility. See J.A. 17, 47-48.

In short, these new Power Act provisions granted the Commission needed authority to subject nonjurisdictional entities, such as intrastate utilities, municipal utilities and rural cooperatives, to orders directing interconnection and wheeling. At the same time, in Section 201(b)(2) of the Power Act, 16 U.S.C. (Supp. V) 824(b)(2), Congress provided that compliance with such orders would not subject these entities to Commission regulation under any other provision of the Power Act.[41]

3. The legislative history of the Power Act provisions supports our submission that Congress was concerned with enhancing efficiency of transmission services, not with imposing limitations on the cogeneration authority

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[40] See similarly Sections 211(a) and 212(a) of the Power Act, 16 U.S.C. (Supp. V) 824j(a) and 824k(a).

[41] Section 201(b)(2) of the Power Act, 16 U.S.C. (Supp. V) 824(b)(2) (as added by Section 204(b)(2) of PURPA) provides:

> The provisions of sections [210, 211] and [212] * * * shall apply to the entities described in such provisions, and such entities shall be subject to the jurisdiction of the Commission for purposes of carrying out such provisions and for purposes of applying the enforcement authorities of this [Act] with respect to such provisions. Compliance with any order of the Commission under the provisions of section [210] or [211] * * * shall not make an electric utility or other entity subject to the jurisdiction of the Commission for any purposes other than the purposes specified in the preceding sentence.

fully provided for in Section 210 of PURPA. As Senator Metzenbaum stated, in explaining the purpose of the Power Act amendments (124 Cong. Rec. 34763-34764 (1978))[42]:

> Individual electric utility systems need to have adequate reserves in the event some of its [sic] generating facilities or transmission lines become inoperable. Unfortunately, to provide for such situations, many utilities have overbuilt. They have made large capital investments in generating facilities which stand idle most of the time. And which add considerably to consumer costs.
>
> A better solution would have been * * * [to] create a national grid * * * to provide a reliable national network of transmission facilities so that when one area is power short, energy could be moved across transmission lines to prevent blackouts like we have seen in New York and New England in recent years * * *. The bill pending before us would certainly not create a national grid. However, it would grant to FERC some authority so that we could prevent wasteful overconstruction of new generating and transmission facilities and make better use of existing facilities.

Although many utility systems are interconnected voluntarily, Congress found it necessary to adopt these new Power Act provisions because some utilities, operating entirely intrastate and therefore beyond the Commission's existing Power Act jurisdiction, had refused to interconnect across the state line in order to avoid becoming subject to the full panoply of Federal Power Act regulation. Senator Bartlett specifically addressed this problem in his

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[42] See also 124 Cong. Rec. 38369 (1978) (remarks of Rep. Dingell introducing the Conference Report on the floor of the House).

discussion of the legislation (124 Cong. Rec. 34770 (1978))[43]:

> The history of these provisions [Sections 210, 211 and 212 of the Power Act], in both the House Committee on Interstate and Foreign Commerce and the Senate Committee on Energy and Natural Resources, shows that one of the problems these provisions are designed to meet is the apparent lack of an appropriate forum in which to resolve the so-called Texas problem. The Electric Reliability Council of Texas, know [sic] as ERCOT, contains the major portion of the electric utilities in Texas and has apparently operated in electrical isolation from the rest of the United States for a number of years * * *.
>
> A number of public utilities operating both within and outside the State of Texas have sought to achieve electrical interconnection between ERCOT and the Southwest power pool, but they have been strongly opposed by several of the major utilities in ERCOT. * * * Whatever the merits of this controversy may be, practically everyone who has seriously addressed the question agrees that there should be full authority in the Federal Energy Regulatory Commission, either on its own motion or on the motion of any of the utilities involved, to hold hearings and decide whether it is in the national interest that the isolation of ERCOT be terminated by any adequate system of interconnection and the necessary coordination to accompany it, or whether the status quo should be maintained.

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[43] See 123 Cong. Rec. 31194 (1977) (remarks of Sen. Johnston); *id.* at 32397-32398 (colloquy between Sen. Domenici and Sen. Johnston); *id.* at 32398-32399 (colloquy between Sen. Bartlett and Sen. Johnston). See also *Public Utility Rate Proposals of President Carter's Energy Program: Hearing on S.122, S.1300, S.1368, S.1364, S.1469 (Part E) Before the Subcomm. on Energy Conservation and Regulation of the Senate Comm. on Energy and Natural Resources*, 95th Cong., 1st Sess., Pt. 3 (1977).

B. Section 210(a) Of PURPA Grants The Commission Complete Authority To Order The Interconnections Necessary To Effectuate The Purchases And Sales Essential To Effectuate A Meaningful Cogeneration Program

1. In Section 210(a) of PURPA, 16 U.S.C. (Supp. V) 824a-3(a), Congress imposed on the Commission the duty to "prescribe * * * such rules as it determines necessary to encourage cogeneration and small power production," including rules requiring utilities to purchase power from and sell power to qualifying facilities. Because physical interconnections are absolutely essential to the consummation of such transactions, the authority to require by rule purchases and sales must necessarily include the power to mandate the necessary interconnections. Thus, a straightforward reading of the express language of Section 210(a) of PURPA fully supports the Commission's view that that provision grants "sufficient authority to require interconnection" (Pet. App. B-60).

This interpretation is confirmed by an examination of Section 210 of PURPA in its entirety, which reveals that Congress intended that statute to constitute a complete and self-contained authority to insure the incorporation of cogeneration and small power production into the electric industry. Thus, Section 210(a) requires utilities to provide a market for electricity generated by such facilities that qualify under the Commission's rules for benefits under PURPA and to provide back-up power for such facilities. Sections 210(b), (c) and (d) assure that the rates at which utilities purchase electricity from and sell back-up power to qualifying facilities are neither discriminatory toward qualifying facilities nor unreasonable to the utilities' customers, and that cogeneration and small power production will not be subsidized by electric utility customers but rather will gain a share of the market only when they are economically competitive

with alternative sources of power. Section 210(e) removes the regulatory impediments to cogeneration and small power production by allowing the Commission to exempt qualifying facilities from state and federal regulation as public utilities. Section 210(f) provides for implementation of the Commission's rules at the state level, and Sections 210(g) and (h) concern enforcement of federal and state rules and judicial review of federal and state action under Section 210.

To conclude, as did the court of appeals, that Congress intended to omit from this comprehensive mandate the very authority that is absolutely essential to make the program work—i.e., the authority of the Commission to direct utilities to hook-up with qualifying facilities—"would be to impute to Congress a purpose to paralyze with one hand what it sought to promote with the other." *Clark* v. *Uebersee Finanz-Korporation, A.G.*, 332 U.S. 480, 489 (1947).

2. The legislative history of Section 210 of PURPA supports the Commission's interpretation. Neither the House nor the Senate version of the legislation that went to conference contained any special procedural prerequisites for interconnections between qualifying facilities and utilities. The Senate bill contained a general mandate to the Secretary of Energy (not the Commission) to recommend "guidelines" to state regulatory commissions that would have required electric utilities to purchase electricity from and sell electricity to qualifying cogenerators and small power producers. S. 2114, Section 12, 95th Cong., 1st Sess. (1977). The House bill, on the other hand, contained a provision that would have directed the Commission to prescribe "rules respecting the interconnection of a qualifying cogeneration facility to the distribution system of any electric utility or to a centrally dispatched power pool * * *." H.R. 8444, Section 546(a)(2), 95th Cong., 1st Sess. (1977). In addition, Section 546(a) of the House bill would have required the Commission to issue rules for allocating costs of a qualifying facility;

rules relating to minimum reliability standards for a qualifying facility; rules regarding the responsibility of an owner or operator of a qualifying facility during a period of electric shortage; and rules specifying the reliability of emergency electric service available to a qualifying facility.[44]

In enacting PURPA, Congress essentially adopted the House version, but it deleted the enumeration of rules relating to interconnection, allocation of costs, reliability and other similar factors. It therefore is reasonable to conclude that Congress viewed the obligation to interconnect as subsumed within the obligation to purchase and sell, which was retained in the legislation as part of Section 210(a) of PURPA.[45]

3. Despite this strong evidence of congressional intent, the court of appeals rejected the Commission's view because in Section 210(e)(3)(B) of PURPA Congress stated that qualifying facilities are not exempt from "the provisions of section 210, 211 or 212 of the Federal Power Act * * *." Viewing this language in isolation, the court below reached the erroneous conclusion that unless this limitation was meant to apply in the context

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[44] It is worth noting that the House version's specific mention of interconnection rules was not written in terms authorizing the Commission to *require* interconnection, or establishing procedural requirements as a precondition for interconnection; the necessity for interconnections appears to have been assumed. By proposing to empower the Commission to include "rules *respecting*" interconnection, along with other rules respecting allocation of costs, reliability, etc., the House was simply anticipating some of the factors involved in establishing the new program of mandating utilities to transact with qualifying facilities.

[45] That Congress assumed utilities and qualifying facilities would be required to interconnect to carry out the mandate of Section 210 is also supported by the Conference Report, which indicates that in setting rates at which utilities sell back-up power to qualifying facilities, the Commission is to disallow "unreasonable hook-up charges." H.R. Conf. Rep. No. 95-1750, *supra*, at 98. See J.A. 18.

of cogeneration, utilities would be "depriv[ed] of the safeguards afforded by" the new Power Act provisions (Pet. App. B-22). As we have demonstrated, however, the limitation in Section 210(e)(3)(B) was necessary in order to make certain that the general exemption of qualifying facilities from the Power Act was not to be read as inconsistent with those new amendments to the Power Act that gave the Commission authority over *any* nonjurisdictional entity that sells electricity. Hence, to insure that the Commission did not reopen the regulatory gap that Congress had just closed, Congress, in Section 210(e)(3)(B), prohibited the Commission from exempting some of those entities—qualifying facilities—from the new authority granted to the Commission to order interconnections.[46]

It seems evident, therefore, that Section 210(e)(3)(B) does not address, much less restrict, the authority granted to the Commission under Section 210(a) of PURPA to require that electric utilities purchase electricity from and sell electricity to qualifying facilities. In seizing upon this provision as dispositive, the court below failed to "look to the provisions of the whole law, and to its object and policy" (*Pennhurst State School and Hospital* v. *Halderman*, 451 U.S. 1, 18 (1981)); as a result it departed completely from the intent of Congress. If the historically reluctant utilities may resist the required purchases and sales by challenging each facilitating interconnection in administrative and judicial proceedings, then Congress' effort to promote development of alterna-

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[46] Similarly, although the Commission may exempt qualifying facilities from state regulation, it is prohibited, in Section 210(e)(3)(A), from exempting qualifying facilities from any state law or regulation implementing Section 210 of PURPA. Here, too, Congress simply was assuring that the Commission would not undermine through regulations what Congress had sought to achieve in the statute.

tive sources of electricity will be stillborn. This Court should reject such a manifest distortion of the congressional purpose.[47]

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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[47] The lower court's suggestion that the Commission could use "streamlined procedures" (Pet. App. B-23) cannot be squared with the statute's definition of "evidentiary hearing" (16 U.S.C. (Supp. V) 796(20)) as "a proceeding conducted as provided in sections 554, 556, and 557 of title 5, [United States Code,]" i.e., the Administrative Procedure Act. Moreover, each interconnection order under the Power Act is subject to judicial review under the substantial evidence test. See 16 U.S.C. 825*l*. The substantial evidence requirement would, as a practical matter, limit efforts to "streamline" proceedings.

APPENDIX

STATUTES AND REGULATIONS INVOLVED

1. Section 210 of PURPA, 16 U.S.C. (Supp. V) 824a-3, provides:

> (a) Not later than 1 year after the date of enactment of this Act, the Commission shall prescribe, and from time to time thereafter revise, such rules as it determines necessary to encourage cogeneration and small power production which rules require electric utilities to offer to—
>
> (1) sell electric energy to qualifying cogeneration facilities and qualifying small power production facilities and
>
> (2) purchase electric energy from such facilities.
>
> Such rules shall be prescribed, after consultation with representatives of Federal and State regulatory agencies having ratemaking authority for electric utilities, and after public notice and a reasonable opportunity for interested persons (including State and Federal agencies) to submit oral as well as written data, views, and arguments. Such rules shall include provisions respecting minimum reliability of qualifying cogeneration facilities and qualifying small power production facilities (including reliability of such facilities during emergencies) and rules respecting reliability of electric energy service to be available to such facilities from electric utilities during emergencies. Such rules may not authorize a qualifying cogeneration facility or qualifying small power production facility to make any sale for purposes other than resale.
>
> (b) The rules prescribed under subsection (a) shall insure that, in requiring any electric utility to offer to purchase electric energy from any qualifying

cogeneration facility or qualifying small power production facility, the rates for such purchase—

(1) shall be just and reasonable to the electric consumers of the electric utility and in the public interest, and

(2) shall not discriminate against qualifying cogenerators or qualifying small power producers.

No such rule prescribed under subsection (a) shall provide for a rate which exceeds the incremental cost to the electric utility of alternative electric energy.

(c) The rules prescribed under subsection (a) shall insure that, in requiring any electric utility to offer to sell electric energy to any qualifying cogeneration facility or qualifying small power production facility, the rates for such sale—

(1) shall be just and reasonable and in the public interest, and

(2) shall not discriminate against the qualifying cogenerators or qualifying small power producers.

(d) For purposes of this section, the term "incremental cost of alternative electric energy" means, with respect to electric energy purchased from a qualifying cogenerator or qualifying small power producer, the cost to the electric utility of the electric energy which, but for the purchase from such cogenerator or small power producer, such utility would generate or purchase from another source.

(e)(1) Not later than 1 year after the date of enactment of this Act and from time to time thereafter, the Commission shall, after consultation with representatives of State regulatory authorities, electric utilities, owners of cogeneration facilities and owners of small power production facilities, and after public notice and a reasonable opportunity for inter-

ested persons (including State and Federal agencies) to submit oral as well as written data, views, and arguments, prescribe rules under which qualifying cogeneration facilities and qualifying small power production facilities are exempted in whole or part from the Federal Power Act, from the Public Utility Holding Company Act, from State laws and regulations respecting the rates, or respecting the financial or organizational regulation, of electric utilities, or from any combination of the foregoing, if the Commission determines such exemption is necessary to encourage cogeneration and small power production.

(2) No qualifying small power production facility which has a power production capacity which, together with any other facilities located at the same site (as determined by the Commission), exceeds 30 megawatts may be exempted under rules under paragraph (1) from any provision of law or regulation referred to in paragraph (1), except that any qualifying small power production facility which produces electric energy solely by the use of biomass as a primary energy source, may be exempted by the Commission under such rules from the Public Utility Holding Company Act and from State laws and regulations referred to in such paragraph (1).

(3) No qualifying small power production facility or qualifying cogeneration facility may be exempted under this subsection from—

(A) any State law or regulation in effect in a State pursuant to subsection (f),

(B) the provisions of section 210, 211, or 212 of the Federal Power Act or the necessary authorities for enforcement of any such provision under the Federal Power Act, or

(C) any license or permit requirement under part I of the Federal Power Act, any provision under such Act related to such a license or

permit requirement, or the necessary authorities for enforcement of any such requirement.

(f) (1) Beginning on or before the date one year after any rule is prescribed by the Commission under subsection (a) or revised under such subsection, each State regulatory authority shall, after notice and opportunity for public hearing, implement such rule (or revised rule) for each electric utility for which it has ratemaking authority.

(2) Beginning on or before the date one year after any rule is prescribed by the Commission under subsection (a) or revised under such subsection, each nonregulated electric utility shall, after notice and opportunity for public hearing, implement such rule (or revised rule).

(g) (1) Judicial review may be obtained respecting any proceeding conducted by a State regulatory authority or nonregulated electric utility for purposes of implementing any requirement of a rule under subsection (a) in the same manner, and under the same requirements, as judicial review may be obtained under section 123 in the case of a proceeding to which section 123 applies.

(2) Any person (including the Secretary) may bring an action against any electric utility, qualifying small power producer, or qualifying cogenerator to enforce any requirement established by a State regulatory authority or nonregulated electric utility pursuant to subsection (f). Any such action shall be brought only in the manner, and under the requirements, as provided under section 123 with respect to an action to which section 123 applies.

(h) (1) For purposes of enforcement of any rule prescribed by the Commission under subsection (a) with respect to any operations of an electric utility, a qualifying cogeneration facility or a qualifying small power production facility which are subject to the jurisdiction of the Commission under part II of

the Federal Power Act, such rule shall be treated as a rule under the Federal Power Act. Nothing in subsection (g) shall apply to so much of the operations of an electric utility, a qualifying cogeneration facility or a qualifying small power production facility as are subject to the jurisdiction of the Commission under part II of the Federal Power Act.

(2) (A) The Commission may enforce the requirements of subsection (f) against any State regulatory authority or nonregulated electric utility. For purposes of any such enforcement, the requirements of subsection (f) (1) shall be treated as a rule enforceable under the Federal Power Act. For purposes of any such action, a State regulatory authority or nonregulated electric utility shall be treated as a person within the meaning of the Federal Power Act. No enforcement action may be brought by the Commission under this section other than—

(i) an action against the State regulatory authority or nonregulated electric utility for failure to comply with the requirements of subsection (f) or

(ii) an action under paragraph (1).

(B) Any electric utility, qualifying cogenerator, or qualifying small power producer may petition the Commission to enforce the requirements of subsection (f) as provided in subparagraph (A) of this paragraph. If the Commission does not initiate an enforcement action under subparagraph (A) against a State regulatory authority or nonregulated electric utility within 60 days following the date on which a petition is filed under this subparagraph with respect to such authority, the petitioner may bring an action in the appropriate United States district court to require such State regulatory authority or nonregulated electric utility to comply with such requirements, and such court may issue such injunc-

tive or other relief as may be appropriate. The Commission may intervene as a matter of right in any such action.

(i) No contract between a Federal agency and any electric utility for the sale of electric energy by such Federal agency for resale which is entered into after the date of the enactment of this Act may contain any provision which will have the effect of preventing the implementation of any rule under this section with respect to such utility. Any provision in any such contract which has such effect shall be null and void.

(j) For purposes of this section, the terms "small power production facility," "qualifying small power production facility," "qualifying small power producer," "primary energy source," "cogeneration facility," "qualifying cogeneration facility," and "qualifying cogenerator" have the respective meanings provided for such terms under section 3 (17) and (18) of the Federal Power Act.

2. Section 210 of the Federal Power Act, 16 U.S.C. (Supp. V) 824i, provides:

(a) (1) Upon application of any electric utility, Federal power marketing agency, geothermal power producer (including a producer which is not an electric utility), qualifying cogenerator, or qualifying small power producer, the Commission may issue an order requiring—

(A) the physical connection of any cogeneration facility, any small power production facility, or the transmission facilities of any electric utility, with the facilities of such applicant.

(B) such action as may be necessary to make effective any physical connection described in subparagraph (A), which physical connection is ineffective for any reason, such as inadequate size, poor maintenance, or physical unreliability,

(C) such sale or exchange of electric energy or other coordination, as may be necessary to carry out the purposes of any order under subparagraph (A) or (B), or

(D) such increase in transmission capacity as may be necessary to carry out the purposes of any order under subparagraph (A) or (B).

(2) Any State regulatory authority may apply to the Commission for an order for any action referred to in subparagraph (A), (B), (C), or (D) of paragraph (1). No such order may be issued by the Commission with respect to a Federal power marketing agency upon application of a State regulatory authority.

(b) Upon receipt of an application under subsection (a) of this section, the Commission shall—

(1) issue notice to each affected State regulatory authority, each affected electric utility, each affected Federal power marketing agency, each affected owner or operator of a cogeneration facility or of a small power production facility, and to the public.

(2) afford an opportunity for an evidentiary hearing, and

(3) make a determination with respect to the matters referred to in subsection (c) of this section.

(c) No order may be issued by the Commission under subsection (a) of this section unless the Commission determines that such order—

(1) is in the public interest,

(2) would—

(A) encourage overall conservation of energy or capital,

(B) optimize the efficiency of use of facilities and resources, or

(C) improve the reliability of any electric utility system or Federal power marketing agency to which the order applies, and

(3) meets the requirements of section 824k of this title.

(d) The Commission may, on its own motion, after compliance with the requirements of paragraphs (1) and (2) of subsection (b) of this section, issue an order requiring any action described in subsection (a)(1) of this section if the Commission determines that such order meets the requirements of subsection (c) of this section. No such order may be issued upon the Commission's own motion with respect to a Federal power marketing agency.

(e)(1) As used in this section, the term "facilities" means only facilities used for the generation or transmission of electric energy.

(2) With respect to an order issued pursuant to an application of a qualifying cogenerator or qualifying small power producer under subsection (a)(1) of this section, the term "facilities of such applicant" means the qualifying cogeneration facilities or qualifying small power production facilities of the applicant, as specified in the application. With respect to an order issued pursuant to an application under subsection (a)(2) of this section, the term "facilities of such applicant" means the qualifying cogeneration facilities, qualifying small power production facilities, or the transmission facilities of an electric utility, as specified in the application. With respect to an order issued by the Commission on its own motion under

subsection (d) of this section, such term means the qualifying cogeneration facilities, qualifying small power production facilities, or the transmission facilities of an electric utility, as specified in the proposed order.

2. Section 211 of the Federal Power Act, 16 U.S.C. (Supp. V) 824j, provides:

(a) Any electric utility, geothermal power producer (including a producer which is not an electric utility), or Federal power marketing agency may apply to the Commission for an order under this subsection requiring any other electric utility to provide transmission services to the applicant (including any enlargement of transmission capacity necessary to provide such services). Upon receipt of such application, after public notice and notice to each affected State regulatory authority, each affected electric utility, and each affected Federal power marketing agency, and after affording an opportunity for an evidentiary hearing, the Commission may issue such order if it finds that such order—

(1) is in the public interest,

(2) would—

(A) conserve a significant amount of energy,

(B) significantly promote the efficient use of facilities and resources, or

(C) improve the reliability of any electric utility system to which the order applies, and

(3) meets the requirements of section 824k of this title.

(b) Any electric utility, or Federal power marketing agency, which purchases electric energy for resale from any other electric utility may apply to the

Commission for an order under this subsection requiring such other electric utility to provide transmission services to the applicant (including any increase in transmission capacity necessary to provide such services). Upon receipt of an application under this subsection, after public notice and notice to each affected State regulatory authority, each affected electric utility, and each affected Federal power marketing agency, and after affording an opportunity for an evidentiary hearing, the Commission may issue such an order if the Commission determines that—

(1) such other electric utility has given actual or constructive notice that it is unwilling or unable to provide electric service to the applicant and has been requested by the applicant to provide the transmission services requested in the application under this subsection, and

(2) such order meets the requirements of section 824k of this title.

(c) (1) No order may be issued under subsection (a) unless the Commission determines that such order would reasonably preserve existing competitive relationships.

(2) No order may be issued under subsection (a) or (b) which requires the electric utility subject to the order to transmit, during any period, an amount of electric energy which replaces any amount of electric energy—

(A) required to be provided to such applicant pursuant to a contract during such period, or

(B) currently provided to the applicant by the utility subject to the order pursuant to a rate schedule on file during such period with the Commission.

(3) No order may be issued under the authority of subsection (a) or (b) which is inconsistent with

any State law which governs the retail marketing areas of electric utilities.

(4) No order may be issued under subsection (a) or (b) which provides for the transmission of electric energy directly to an ultimate consumer.

(d) (1) Any electric utility ordered under subsection (a) or (b) to provide transmission services may apply to the Commission for an order permitting such electric utility to cease providing all, or any portion of, such services. After public notice, notice to each affected State regulatory authority, each affected Federal power marketing agency, and each affected electric utility, and after an opportunity for an evidentiary hearing, the Commission shall issue an order terminating or modifying the order issued under subsection (a) or (b), if the electric utility providing such transmission services has demonstrated, and the Commission has found, that—

(A) due to changed circumstances, the requirements applicable, under this section and section 824k of this title, to the issuance of an order under subsection (a) or (b) are no longer met, or

(B) any transmission capacity of the utility providing transmission services under such order which was, at the time such order was issued, in excess of the capacity necessary to serve its own customers is no longer in excess of the capacity necessary for such purposes.

No order shall be issued under this subsection pursuant to a finding under subparagraph (A) unless the Commission finds that such order is in the public interest.

(2) Any order issued under this subsection terminating or modifying an order issued under subsection (a) or (b) shall—

(A) provide for any appropriate compensation, and

(B) provide the affected electric utilities adequate opportunity and time to—

(i) make suitable alternative arrangements for any transmission services terminated or modified, and

(ii) insure that the interests of ratepayers of such utilities are adequately protected.

(3) No order may be issued under this subsection terminating or modifying any order issued under subsection (a) or (b) if the order under subsection (a) or (b) includes terms and conditions agreed upon by the parties which—

(A) fix a period during which transmission services are to be provided under the order under subsection (a) or (b), or

(B) otherwise provide procedures or methods for terminating or modifying such order (including, if appropriate, the return of the transmission capacity when necessary to take into account an increase, after the issuance of such order, in the needs of the electric utility subject to such order for transmission capacity).

(e) As used in this section, the term "facilities" means only facilities used for the generation or transmission of electric energy.

3. Section 212 of the Federal Power Act, 16 U.S.C. (Supp. V) 824k, provides in pertinent part:

(a) No order may be issued by the Commission under section 824i or subsection (a) or (b) of section 824j of this title unless the Commission determines that such order—

(1) is not likely to result in a reasonably ascertainable uncompensated economic loss for any electric utility, qualifying cogenerator, or

qualifying small power producer, as the case may be, affected by the order;

(2) will not place an undue burden on an electric utility, qualifying cogenerator, or qualifying small power producer, as the case may be, affected by the order;

(3) will not unreasonably impair the reliability of any electric utility affected by the order; and

(4) will not impair the ability of any electric utility affected by the order to render adequate service to its customers.

The determination under paragraph (1) shall be based upon a showing of the parties. The Commission shall have no authority under section 824i or 824j of this title to compel the enlargement of generating facilities.

(b) No order may be issued under section 824i or subsection (a) or (b) of section 824j of this title unless the applicant for such order demonstrates that he is ready, willing, and able to reimburse the party subject to such order for—

(1) in the case of an order under section 824i of this title, such party's share of the reasonably anticipated costs incurred under such order, and

(2) in the case of an order under subsection (a) or (b) of section 824j of this title—

(A) the reasonable costs of transmission services, including the costs of any enlargement of transmission facilities, and

(B) a reasonable rate of return on such costs, as appropriate, as determined by the Commission.

(c) (1) Before issuing an order under section 824i or subsection (a) or (b) of section 824j of this

title, the Commission shall issue a proposed order and set a reasonable time for parties to the proposed interconnection or transmission order to agree to terms and conditions under which such order is to be carried out, including the apportionment of costs between them and the compensation or reimbursement reasonably due to any of them. Such proposed order shall not be reviewable or enforceable in any court. The time set for such parties to agree to such terms and conditions may be shortened if the Commission determines that delay would jeopardize the attainment of the purposes of any proposed order. Any terms and conditions agreed to by the parties shall be subject to the approval of the Commission.

(2) (A) If the parties agree as provided in paragraph (1) within the time set by the Commission and the Commission approves such agreement, the terms and conditions shall be included in the final order. In the case of an order under section 824i of this title, if the parties fail to agree within the time set by the Commission or if the Commission does not approve any such agreement, the Commission shall prescribe such terms and conditions and include such terms and conditions in the final order.

(B) In the case of any order applied for under section 824j of this title, if the parties fail to agree within the time set by the Commission, the Commission shall prescribe such terms and conditions in the final order.

(d) If the Commission does not issue any order applied for under section 824i or 824j or this title, the Commission shall, by order, deny such application and state the reasons for such denial.

(e) No provision of section 824i or 824j of this title shall be treated—

(1) as requiring any person to utilize the authority of such section 824i or 824j of this title in lieu of any other authority of law, or

(2) as limiting, impairing, or otherwise affecting any authority of the Commission under any other provision of law.

4. 18 C.F.R. Subchapter K provides in pertinent part:

SUBPART A—GENERAL PROVISIONS

§ 292.101 *Definitions.*

(a) *General rule.* Terms defined in the Public Utility Regulatory Policies Act of 1978 (PURPA) shall have the same meaning for purposes of this part as they have under PURPA, unless further defined in this part.

(b) *Definitions.* The following definitions apply for purposes of this part.

(1) "Qualifying facility" means a cogeneration facility or a small power production facility which is a qualifying facility under Subpart B of this part of the Commission's regulations.

(2) "Purchase" means the purchase of electric energy or capacity or both from a qualifying facility by an electric utility.

(3) "Sale" means the sale of electric energy or capacity or both by an electric utility to a qualifying facility.

(4) "System emergency" means a condition on a utility's system which is likely to result in imminent significant disruption of service to customers or is imminently likely to endanger life or property.

(5) "Rate" means any price, rate, charge, or classification made, demanded, observed or received with respect to the sale or purchase of electric energy or capacity, or any rule, regulation, or practice respecting any such rate, charge, or classification, and any contract pertaining to the sale or purchase of electric energy or capacity.

(6) "Avoided costs" means the incremental costs to an electric utility of electric energy or capacity or both which, but for the purchase from the qualifying facility or qualifying facilities, such utility would generate itself or purchase from another source.

(7) "Interconnection costs" means the reasonable costs of connection, switching, metering, transmission, distribution, safety provisions and administrative costs incurred by the electric utility directly related to the installation and maintenance of the physical facilities necessary to permit interconnected operations with a qualifying facility, to the extent such costs are in excess of the corresponding costs which the electric utility would have incurred if it had not engaged in interconnected operations, but instead generated an equivalent amount of electric energy itself or purchased an equivalent amount of electric energy or capacity from other sources. Interconnection costs do not include any costs included in the calculation of avoided costs.

(8) "Supplementary power" means electric energy or capacity supplied by an electric utility, regularly used by a qualifying facility in addition to that which the facility generates itself.

(9) "Back-up power" means electric energy or capacity supplied by an electric utility to replace energy ordinarily generated by a facility's own generation equipment during an unscheduled outage of the facility.

(10 "Interruptible power" means electric energy or capacity supplied by an electric utility subject to interruption by the electric utility under specified conditions.

(11) "Maintenance power" means electric energy or capacity supplied by an electric utility during scheduled outages of the qualifying facility.

SUBPART B—[RESERVED]

SUBPART C—ARRANGEMENTS BETWEEN ELECTRIC UTILITIES AND QUALIFYING COGENERATION AND SMALL POWER PRODUCTION FACILITIES UNDER SECTION 210 OF THE PUBLIC UTILITY REGULATORY POLICIES ACT OF 1978

§ 292.301 *Scope.*

(a) *Applicability.* This subpart applies to the regulation of sales and purchases between qualifying facilities and electric utilities.

(b) *Negotiated rates or terms.* Nothing in this subpart:

(1) limits the authority of any electric utility or any qualifying facility to agree to a rate for any purchase, or terms or conditions relating to any purchase, which differ from the rate or terms or conditions which would otherwise be required by this subpart; or

(2) affects the validity of any contract entered into between a qualifying facility and an electric utility for any purchase.

§ 292.302 *Availability of electric utility system cost data.*

(a) *Applicability.* (1) Except as provided in subparagraph (2), paragraph (b) applies to each electric utility, in any calendar year, if the total sales of electric energy by such utility for purposes other than resale exceeded 500 million kilowatt-hours during any calendar year beginning after December 31, 1975, and before the immediately preceding calendar year.

(2) Each utility having total sales of electric energy for purposes other than resale of less than one billion kilowatt-hours during any calendar year beginning after December 31, 1975, and before the im-

mediately preceding year, shall not be subject to the provisions of this section until May 31, 1982.

(b) *General rule.* To make available data from which avoided costs may be derived, not later than November 1, 1980, May 31, 1982, and not less often than every two years thereafter, each regulated electric utility described in paragraph (a) shall provide to its State regulatory authority, and shall maintain for public inspection, and each nonregulated electric utility described in paragraph (a) shall maintain for public inspection, the following data:

(1) the estimated avoided cost on the electric utility's system, solely with respect to the energy component, for various levels of purchases from qualifying facilities. Such levels of purchases shall be stated in blocks of not more than 100 megawatts for systems with peak demand of 1000 megawatts or more, and in blocks equivalent to not more than 10 percent of the system peak demand for systems of less than 1000 megawatts. The avoided costs shall be stated on a cents per kilowatt-hour basis, during daily and seasonal peak and off-peak periods, by year, for the current calendar year and each of the next 5 years;

(2) the electric utility's plan for the addition of capacity by amount and type, for purchases of firm energy and capacity, and for capacity retirements for each year during the succeeding 10 years; and

(3) the estimated capacity costs at completion of the planned capacity additions and planned capacity firm purchases, on the basis of dollars per kilowatt, and the associated energy costs of each unit, expressed in cents per kilowatt hour. These costs shall be expressed in terms of individual generating units and of individual planned firm purchases.

(c) *Special rule for small electric utilities.*

(1) Each electric utility (other than any electric utility to which paragraph (b) applies) shall, upon request:

(i) provide comparable data to that required under paragraph (b) to enable qualifying facilities to estimate the electric utility's avoided costs for periods described in paragraph (b); or

(ii) with regard to an electric utility which is legally obligated to obtain all its requirements for electric energy and capacity from another electric utility, provide the data of its supplying utility and the rates at which it currently purchases such energy and capacity.

(2) If any such electric utility fails to provide such information on request, the qualifying facility may apply to the State regulatory authority (which has ratemaking authority over the electric utility) or the Commission for an order requiring that the information be provided.

(d) *Substitution of alternative method.* (1) After public notice in the area served by the electric utility, and after opportunity for public comment, any State regulatory authority may require (with respect to any electric utility over which it has ratemaking authority), or any nonregulated electric utility may provide, data different than those which are otherwise required by this section if it determines that avoided costs can be derived from such data.

(2) Any State regulatory authority (with respect to any electric utility over which it has ratemaking authority) or nonregulated utility which requires such different data shall notify the Commission within 30 days of making such determination.

(e) *State review.* (1) Any data submitted by an electric utility under this section shall be subject to review by the State regulatory authority which has ratemaking authority over such electric utility.

(2) In any such review, the electric utility has the burden of coming forward with justification for its data.

§ 292.303 *Electric utility obligations under the subpart.*

(a) *Obligation to purchase from qualifying facilities.* Each electric utility shall purchase, in accordance with § 292.304, any energy and capacity which is made available from a qualifying facility:

(1) directly to the electric utility; or

(2) indirectly to the electric utility in accordance with paragraph (d).

(b) *Obligation to sell to qualifying facilities.* Each electric utility shall sell to any qualifying facility, in accordance with § 292.305, any energy and capacity requested by the qualifying facility.

(c) *Obligation to interconnect.* (1) Subject to subparagraph (2), any electric utility shall make such interconnections with any qualifying facility as may be necessary to accomplish purchases or sales under this subpart. The obligation to pay for any interconnection costs shall be determined in accordance with § 292.306.

(2) No electric utility is required to interconnect with any qualifying facility if, solely by reason of purchases or sales over the interconnection, the electric utility would become subject to regulation as a public utility under Part II of the Federal Power Act.

(d) *Transmission to other electric utilities.* If a qualifying facility agrees, an electric utility which would otherwise be obligated to purchase energy or capacity from such qualifying facility may transmit the energy or capacity to any other electric utility. Any electric utility to which such energy or capacity is transmitted shall purchase such energy capacity under this subpart as if the qualifying facility were supplying energy or capacity directly to such electric utility. The rate for purchase by the electric utility to which such energy is transmitted shall be adjusted

up or down to reflect line losses pursuant to § 292.304(e)(4) and shall not include any charges for transmission.

(e) *Parallel operation.* Each electric utility shall offer to operate in parallel with a qualifying facility, provided that the qualifying facility complies with any applicable standards established in accordance with § 292.308.

§ 292.304 *Rates for purchases.*

(a) *Rates for purchases.* (1) Rates for purchases shall:

(i) be just and reasonable to the electric consumer of the electric utility and in the public interest; and

(ii) not discriminate against qualifying cogeneration and small power production facilities.

(2) Nothing in this subpart requires any electric utility to pay more than the avoided costs for purchases.

(b) *Relationship to avoided costs.* (1) For purposes of this paragraph, "new capacity" means any purchase from capacity of a qualifying facility, construction of which was commenced on or after November 9, 1978.

(2) Subject to subparagraph (3), a rate for purchases satisfies the requirements of paragraph (a) if the rate equals the avoided costs determined after consideration of the factors set forth in paragraph (e).

(3) A rate for purchases (other than from new capacity) may be less than the avoided cost if the State regulatory authority (with respect to any electric utility over which it has ratemaking authority) or the nonregulated electric utility determines that a lower rate is consistent with paragraph (a), and is sufficient to encourage cogeneration and small power production.

(4) Rates for purchases from new capacity shall be in accordance with subparagraph (2), regardless of whether the electric utility making such purchases is simultaneously making sales to the qualifying facility.

(5) In the case in which the rates for purchases are based upon estimates of avoided costs over the specific term of the contract or other legally enforceable obligation, the rates for such purchases do not violate this subpart if the rates for such purchases differ from avoided costs at the time of delivery.

(c) *Standard rates for purchases.* (1) There shall be put into effect (with respect to each electric utility) standard rates for purchases from qualifying facilities with a design capacity of 100 kilowatts or less.

(2) There may be put into effect standard rates for purchases from qualifying facilities with a design capacity of more than 100 kilowatts.

(3) The standard rates for purchases under this paragraph:

(i) shall be consistent with paragraphs (a) and (e); and

(ii) may differentiate among qualifying facilities using various technologies on the basis of the supply characteristics of the different technologies.

(d) *Purchases "as available" or pursuant to a legally enforceable obligation.* Each qualifying facility shall have the option either:

(1) to provide energy as the qualifying facility determines such energy to be available for such purchases, in which case the rates for such purchases shall be based on the purchasing utility's avoided costs calculated at the time of delivery; or

(2) to provide energy or capacity pursuant to a legally enforceable obligation for the delivery of energy or capacity over a specified term, in which case the rates for such purchases shall, at the option

of the qualifying facility exercised prior to the beginning of the specified term, be based on either:

(i) the avoided costs calculated at the time of delivery; or

(ii) the avoided costs calculated at the time the obligation is incurred.

(e) *Factors affecting rates for purchases.* In determining avoided costs, the following factors shall, to the extent practicable, be taken into account:

(1) the data provided pursuant to § 292.302(b), (c), or (d), including State review of any such data;

(2) the availability of capacity or energy from a qualifying facility during the system daily and seasonal peak periods, including:

(i) the ability of the utility to dispatch the qualifying facility;

(ii) the expected or demonstrated reliability of the qualifying facility;

(iii) the terms of any contract or other legally enforceable obligation, including the duration of the obligation, termination notice requirement and sanctions for non-compliance;

(iv) the extent to which scheduled outages of the qualifying facility can be usefully coordinated with scheduled outages of the utility's facilities;

(v) the usefulness of energy and capacity supplied from a qualifying facility during system emergencies, including its ability to separate its load from its generation;

(vi) the individual and aggregate value of energy and capacity from qualifying facilities on the electric utility's system; and

(vii) the smaller capacity increments and the shorter lead times available with additions of capacity from qualifying facilities; and

(3) the relationship of the availability of energy or capacity from the qualifying facility as derived in subparagraph (2), to the ability of the electric utility to avoid costs, including the deferral of capacity additions and the reduction of fossil fuel use; and

(4) the costs or savings resulting from variations in line losses from those that would have existed in the absence of purchases from a qualifying facility, if the purchasing electric utility generated an equivalent amount of energy itself or purchased an equivalent amount of electric energy or capacity.

(f) *Periods during which purchases not required.*

(1) Any electric utility which gives notice pursuant to subparagraph (2) will not be required to purchase electric energy or capacity during any period during which, due to operational circumstances, purchases from qualifying facilities will result in costs greater than those which the utility would incur if it did not make such purchases, but instead generated an equivalent amount of energy itself.

(2) Any electric utility seeking to invoke subparagraph (1) must notify, in accordance with applicable State law or regulation, each affected qualifying facility in time for the qualifying facility to cease the delivery of energy or capacity to the electric utility.

(3) Any electric utility which fails to comply with with the provisions of subparagraph (2) will be required to pay the same rate for such purchase of energy or capacity as would be required had the period described in subparagraph (1) not occurred.

(4) A claim by an electric utility that such a period has occurred or will occur is subject to such verification by its State regulatory authority as the State regulatory authority determines necessary or appropriate, either before or after the occurrence.

§ 292.305 *Rates for sales.*

(a) *General rules.* (1) Rates for sales:

(i) shall be just and reasonable and in the public interest; and

(ii) shall not discriminate against any qualifying facility in comparison to rates for sales to other customers served by the electric utility.

(2) Rates for sales which are based on accurate data and consistent systemwide costing principles shall not be considered to discriminate against any qualifying facility to the extent that such rates apply to the utility's other customers with similar load or other cost-related characteristics.

(b) *Additional Services to be Provided to Qualifying Facilities.* (1) Upon request of a qualifying facility, each electric utility shall provide:

(i) supplementary power;

(ii) back-up power;

(iii) maintenance power; and

(iv) interruptible power.

(2) The State regulatory authority (with respect to any electric utility over which it has ratemaking authority) and the Commission (with respect to any nonregulated electric utility) may waive any requirement of subparagraph (1) if, after notice in the area served by the electric utility and after opportunity for public comment, the electric utility demonstrates and the State regulatory authority or the Commission, as the case may be, finds that compliance with such requirement will:

(i) impair the electric utility's ability to render adequate service to its customers; or

(ii) place an undue burden on the electric utility.

(c) *Rates for sales of back-up and maintenance power.* The rate for sales of back-up power or maintenance power:

(1) shall not be based upon an assumption (unless supported by factual data) that forced outages or other reductions in electric output by all qualifying facilities on an electric utility's system will occur simultaneously, or during the system peak, or both; and

(2) shall take into account the extent to which scheduled outages of the qualifying facilities can be usefully coordinated with scheduled outages of the utility's facilities.

§ 292.306 *Interconnection costs.*

(a) *Obligation to pay.* Each qualifying facility shall be obligated to pay any interconnection costs which the State regulatory authority (with respect to any electric utility over which it has ratemaking authority) or nonregulated electric utility may assess against the qualifying facility on a nondiscriminatory basis with respect to other customers with similar load characteristics.

(b) *Reimbursement of interconnection costs.* Each State regulatory authority (with respect to any electric utility over which it has ratemaking authority) and nonregulated utility shall determine the manner for payments of interconnection costs, which may include reimbursement over a reasonable period of time.

§ 292.307 *System emergencies.*

(a) *Qualifying facility obligation to provide power during system emergencies.* A qualifying facility shall be required to provide energy or capacity to an electric utility during a system emergency only to the extent:

(1) provided by agreement between such qualifying facility and electric utility; or

(2) ordered under section 202(c) of the Federal Power Act.

(b) *Discontinuance of purchases and sales during system emergencies.* During any system emergency, an electric utility may discontinue:

(1) purchases from a qualifying facility if such purchases would contribute to such emergency; and

(2) sales to a qualifying facility, provided that such discontinuance is on a nondiscriminatory basis.

§ 292.308 *Standards for operating reliability.*

Any State regulatory authority (with respect to any electric utility over which it has ratemaking authority) or nonregulated electric utility may establish reasonable standards to ensure system safety and reliability of interconnected operations. Such standards may be recommended by any electric utility, any qualifying facility, or any other person. If any State regulatory authority (with respect to any electric utility over which it has ratemaking authority) or nonregulated electric utility establishes such standards, it shall specify the need for such standards on the basis of system safety and reliability.

SUBPART D—IMPLEMENTATION

§ 292.401 *Implementation by State regulatory authorities and nonregulated electric utilities.*

(a) *State regulatory authorities.* Not later than one year after these rules take effect, each State regulatory authority shall, after notice and an opportunity for public hearing, commence implementation of Subpart C (other than § 292.302 thereof). Such implementation may consist of the issuance of regulations, an undertaking to resolve disputes between qualifying facilities and electric utilities arising under Subpart C, or any other action reasonably

designed to implement such subpart (other than § 292.302 thereof).

(b) *Nonregulated electric utilities.* Not later than one year after these rules take effect, each nonregulated electric utility shall, after notice and an opportunity for public hearing, commence implementation of Subpart C (other than § 292.302 thereof). Such implementation may consist of the issuance of regulations, an undertaking to comply with Subpart C, or any other action reasonably designed to implement such subpart (other than § 292.302 thereof).

(c) *Reporting requirement.* Not later than one year after these rules take effect, each State regulatory authority and nonregulated electric utility shall file with the Commission a report describing the manner in which it will implement Subpart C (other than § 292.302 thereof).

§ 292.402 *Implementation of Certain Reporting Requirements.*

Any electric utility which fails to comply with the requirements of § 292.302(b) shall be subject to the same penalties to which it may be subjected for failure to comply with the requirements of the Commission's regulations issued under section 133 of PURPA.

§ 292.403 *Waivers.*

(a) *State regulatory authority and nonregulated electric utility waivers.* Any State regulatory authority (with respect to any electric utility over which it has ratemaking authority) or nonregulated electric utility may, after public notice in the area served by the electric utility, apply for a waiver from the application of any of the requirements of Subpart C (other than § 292.302 thereof).

(b) *Commission action.* The Commission will grant such a waiver only if an applicant under para-

graph (a) demonstrates that compliance with any of the requirements of Subpart C is not necessary to encourage cogeneration and small power production and is not otherwise required under section 210 of PURPA.

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SUBPART F—EXEMPTION OF QUALIFYING SMALL POWER PRODUCTION FACILITIES AND COGENERATION FACILITIES FROM CERTAIN FEDERAL AND STATE LAWS AND REGULATIONS

§ 292.601 *Exemption to qualifying facilities from the Federal Power Act.*

(a) *Applicability.* This section applies to:

(1) qualifying cogeneration facilities; and

(2) qualifying small power production facilities which have a power production capacity which does not exceed 30 megawatts.

(b) *General rule.* Any qualifying facility described in paragraph (a) shall be exempt from all sections of the Federal Power Act, except:

(1) sections 1-30;

(2) sections 202(c), 210, 211, and 212;

(3) section 305(c); and

(4) any necessary enforcement provision of Part III with regard to the sections listed in subparagraphs (1), (2) and (3).

§ 292.602 *Exemption to qualifying facilities from the Public Utility Holding Company Act and certain State law and regulation.*

(a) *Applicability.* This section applies to any qualifying facility described in § 292.601(a), and to any qualifying small power production facility with a power production capacity over 30 megawatts if such facility produces electric energy solely by the use of biomass as a primary energy source.

(b) *Exemption from the Public Utility Holding Company Act of 1935.* A qualifying facility described in paragraph (a) shall not be considered to be an "electric utility company" as defined in section 2(a)(3) of the Public Utility Holding Company Act of 1935, 15 U.S.C. § 79b(a)(3).

(c) *Exemption from certain State law and regulation.*

(1) Any qualifying facility shall be exempted (except as provided in subparagraph (2)) from State law or regulation respecting:

(i) the rates of electric utilities; and

(ii) the financial and organizational regulation of electric utilities.

(2) A qualifying facility may not be exempted from State law and regulation implementing Subpart C.

(3) Upon request of a State regulatory authority or nonregulated electric utility, the Commission may consider a limitation on the exemptions specified in subparagraph (1).

(4) Upon request of any person, the Commission may determine whether a qualifying facility is exempt from a particular State law or regulation.

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